



Effective Tax Rates in Australia Today: An Overview and Some Issues

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What are Effective Marginal Tax Rates?

- EMTRs measure the proportion of an additional dollar of earnings that is lost to both income tax and the reduction of income-tested government benefits (e.g. Newstart, Aged Pension, Family Tax Benefit (FTB)).
- An EMTR of 70% means that of an additional dollar of earnings only 30c is retained 'in the hand'.

Why are EMTRs important?

- Governments face a balancing act in setting income-tests for benefits to ensure that benefits go to those who most need them, but also not discouraging people from working.
- High EMTRs can create poverty traps, and discourage people from increasing their labour force participation.
- Issue affects both individuals and families, and governments

Methodology

- Used NATSEM's STINMOD model, a static microsimulation model of the Australian Tax and Transfer system
- Add \$1 to income of income unit reference person, then compare the income unit's disposable (after tax) income before and after the increase. This is repeated for the spouse, so that what we are looking at is the *income unit's* EMTR, as it is faced by each *individual*.
- Study includes all individuals of working age (15-65 years).
- Represents social security and tax rules as at 2006-07

Methodology (cont')

■ Study excludes

- dependent students aged 16-24
- people with negative EMTRs
- People who's Medicare Levy will increase by more than \$1 with a \$1 increase in private income

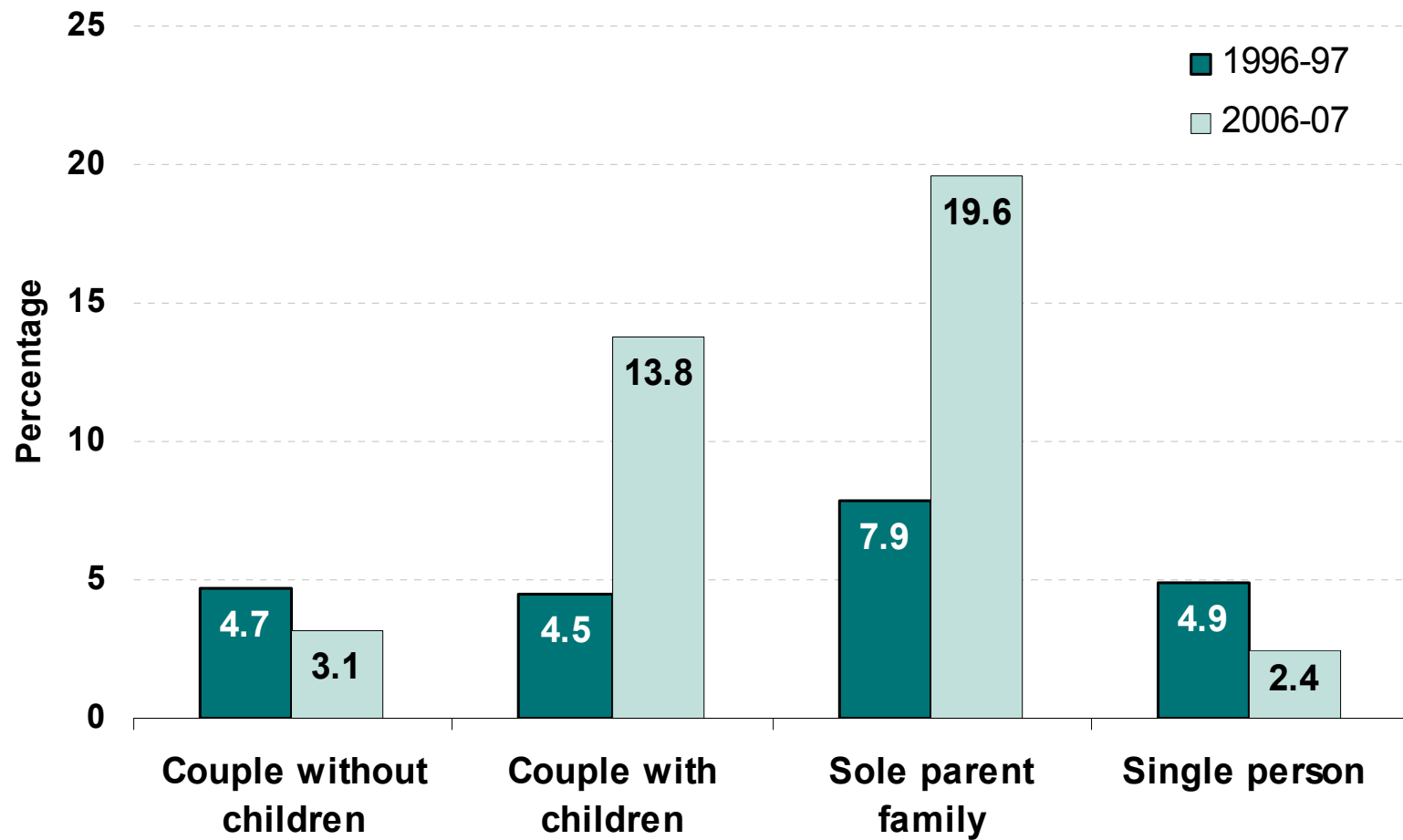
■ Does not take account of:

- Costs associated with loss of concession cards
- Increased rent for public housing tenants
- Childcare rebates
- Working Credit Scheme
- Other work related costs, such as childcare, clothing, transport

'High' EMTRs

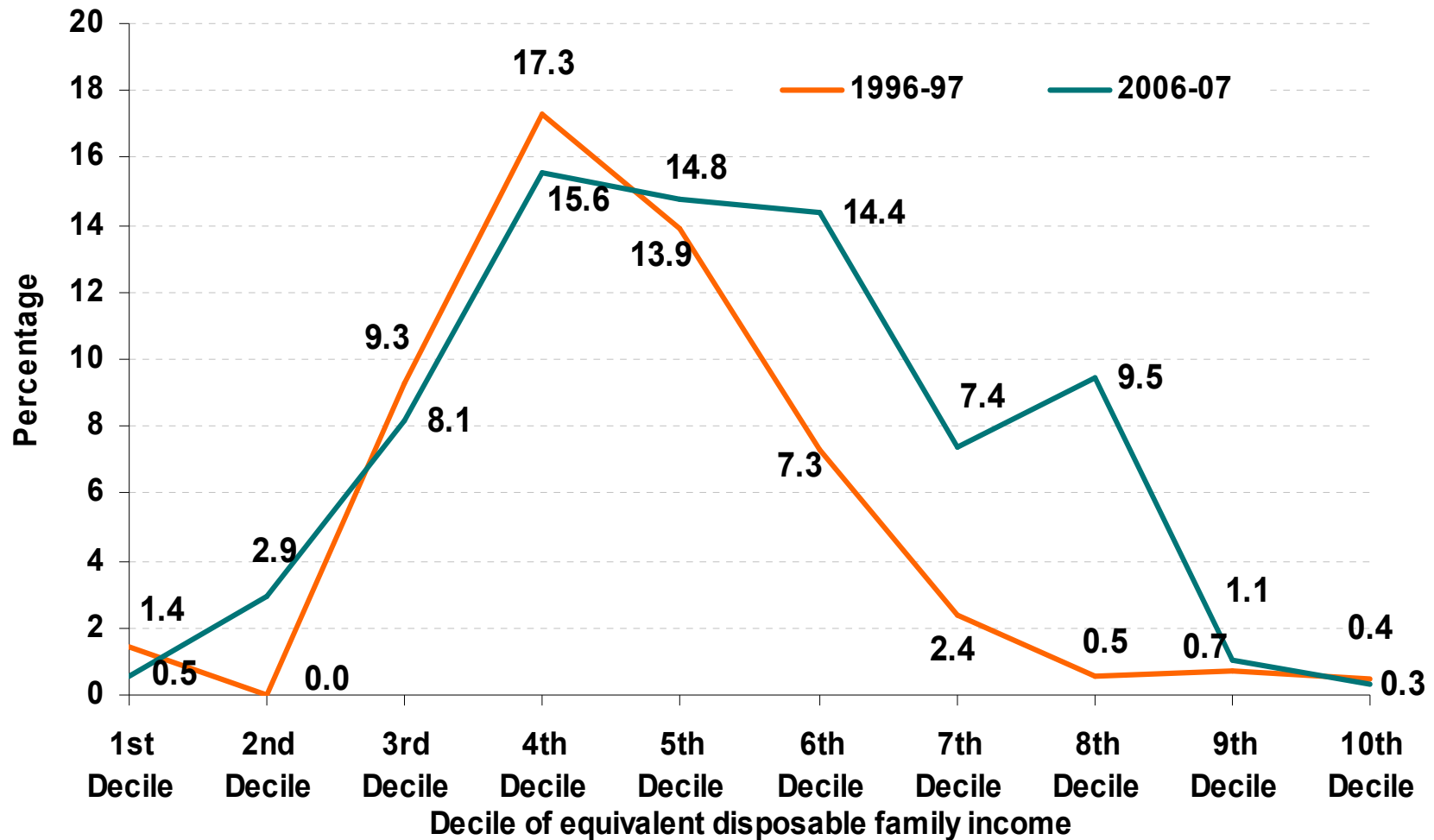
- 'High' EMTRs are defined here as greater than 50%, as this exceeds tax rate of millionaires
- Means people stand to keep only 50c or less from an additional \$1 of earnings
- In 2006-07, 7.1 % of working-age Australians (910,000 people) face EMTRs of 50c in the dollar or more.
- In 1996-97, 4.8% of working age Australians faced high EMTRs.
- Some groups are more likely to experience high EMTRs...

Proportion of each family type with high EMTRs



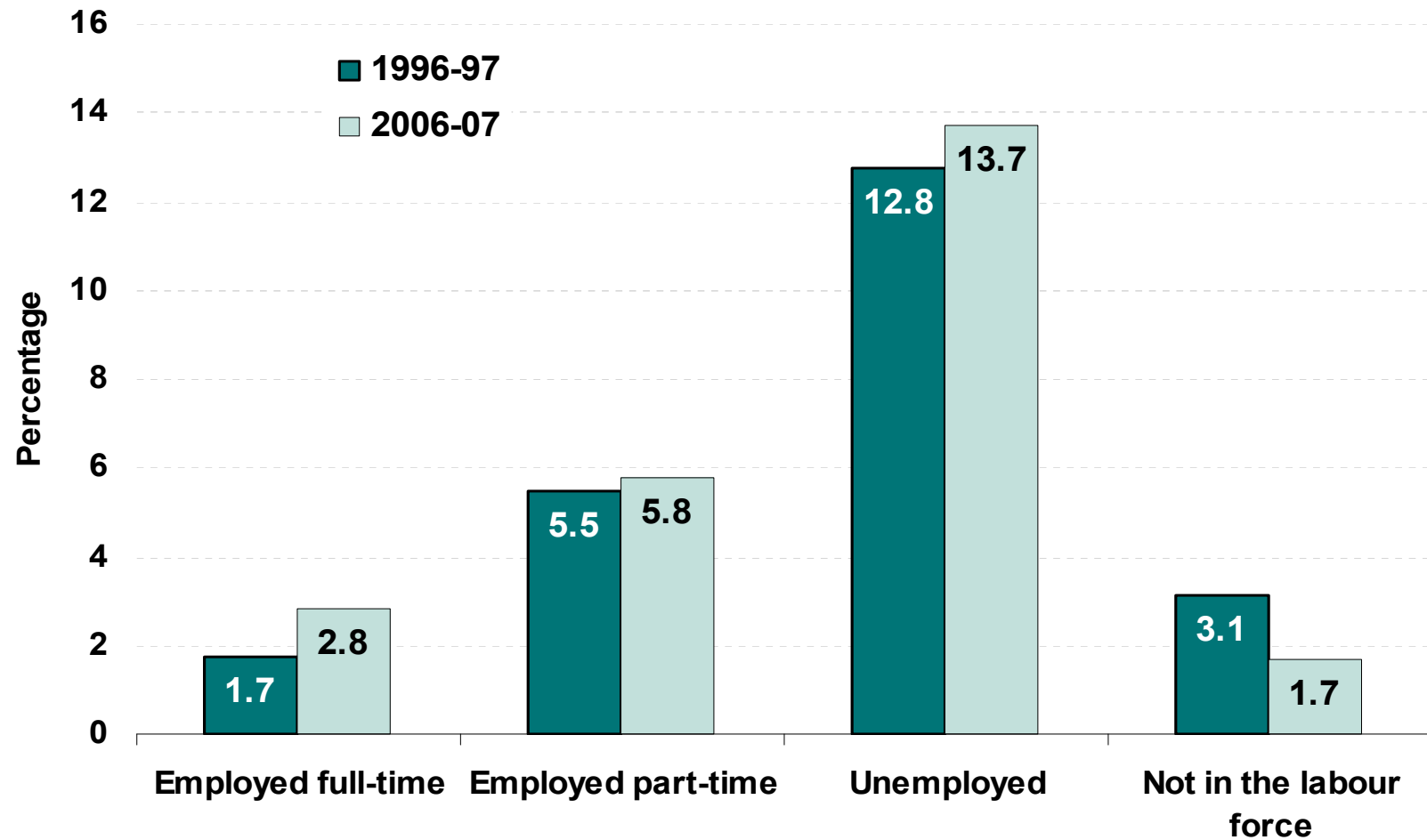
Source: Harding et al, 2006

Distribution of EMTRs by decile, 1996-97 and 2006-07



Source: Harding et al, 2006

Proportion of each labour force status group with high EMTRs



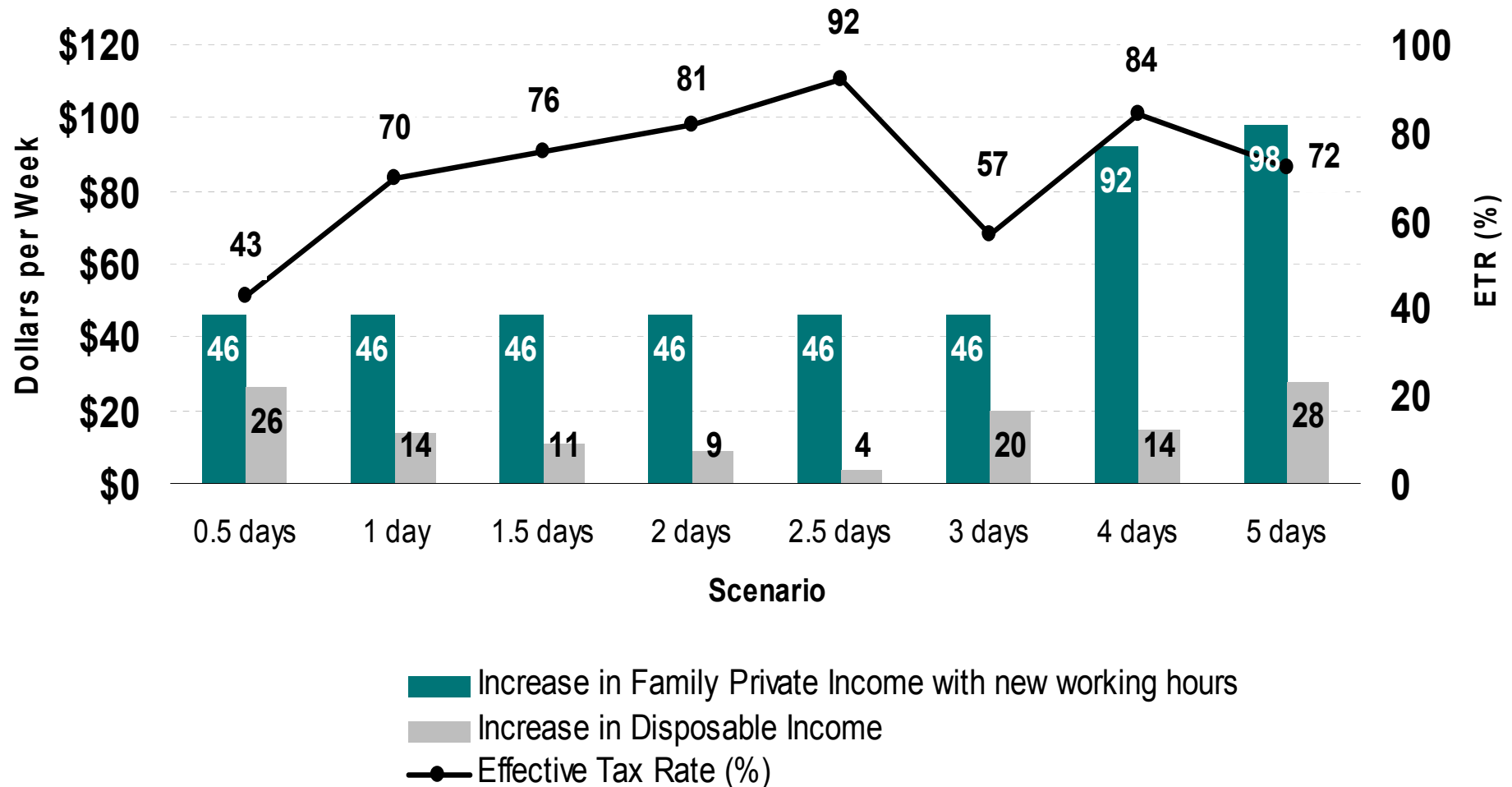
Source: Harding et al, 2006

For mothers married to low income fathers, it may not be worth working

- Shows families' ETRs as 'father' works full-time and 'mother' increases work hours from 0 to full-time over 8 incremental scenarios
- Dad earns \$512 a week; mum earns \$12.30 an hour
 - ½ ABS AWE for men and women respectively in 2006-07
- Childcare cost included at assumed rate of \$5 an hour
- Results use STINMOD – NATSEM's microsimulation model of the Australian tax and transfer system for 2007-08

Scenario in following graph	Mother's Paid Working Hours	Assumed Childcare Hours
1. Half a day	•3.75	•5
1. One day or two half days	•7.5	•10
1. One and a half days work	•11.25	•15
1. Two days work	•15	•20
1. Two and a half days	•18.75	•25
1. Three days	•22.5	•30
1. Four days	•30	•40
1. Full-time	•38	•50

'Low' income family with one child in LDC, one child at school, 2007-08

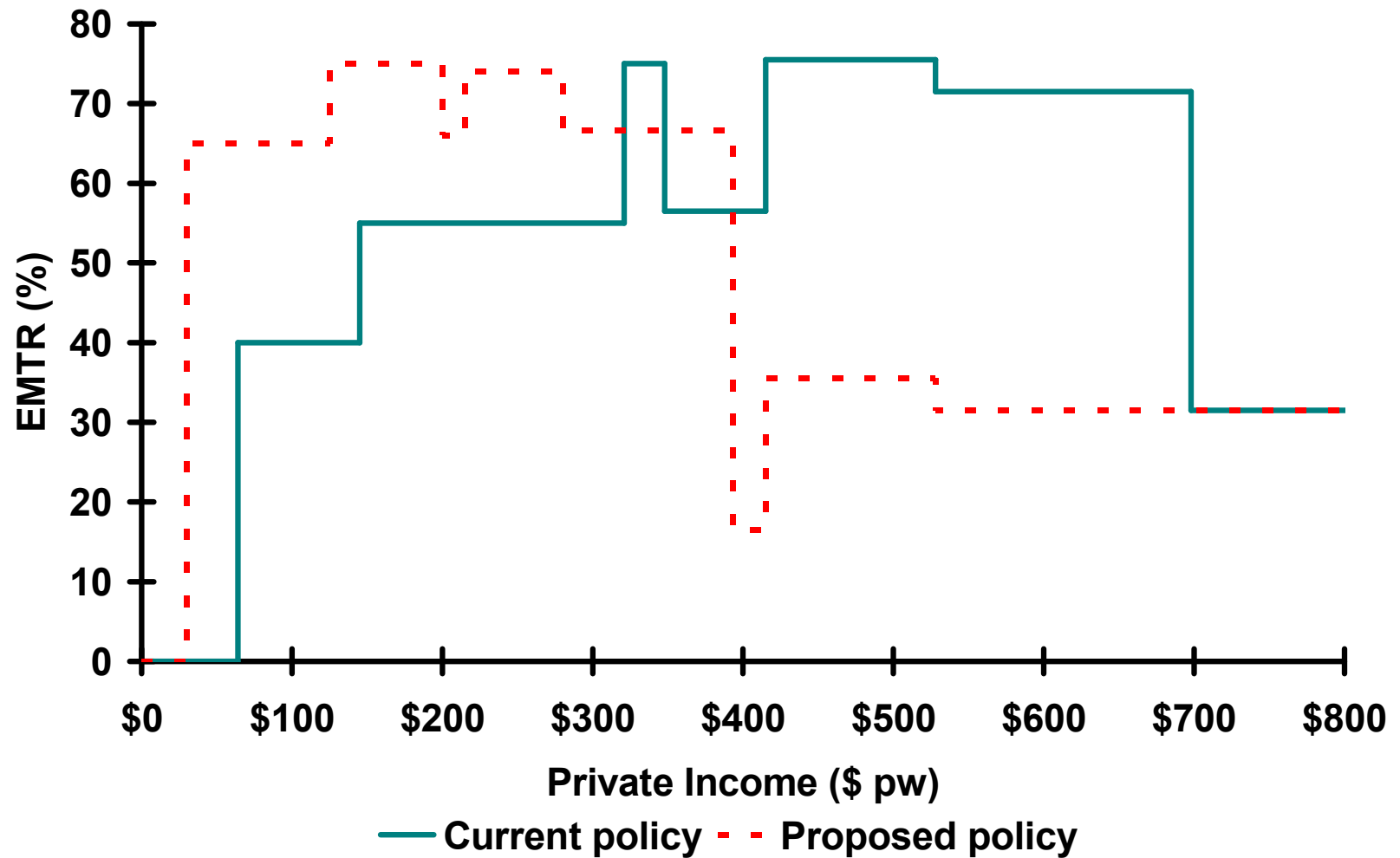


Source: Payne et al, 2007. LDC = long day care

The Welfare to Work Reforms: which people with disabilities affected?

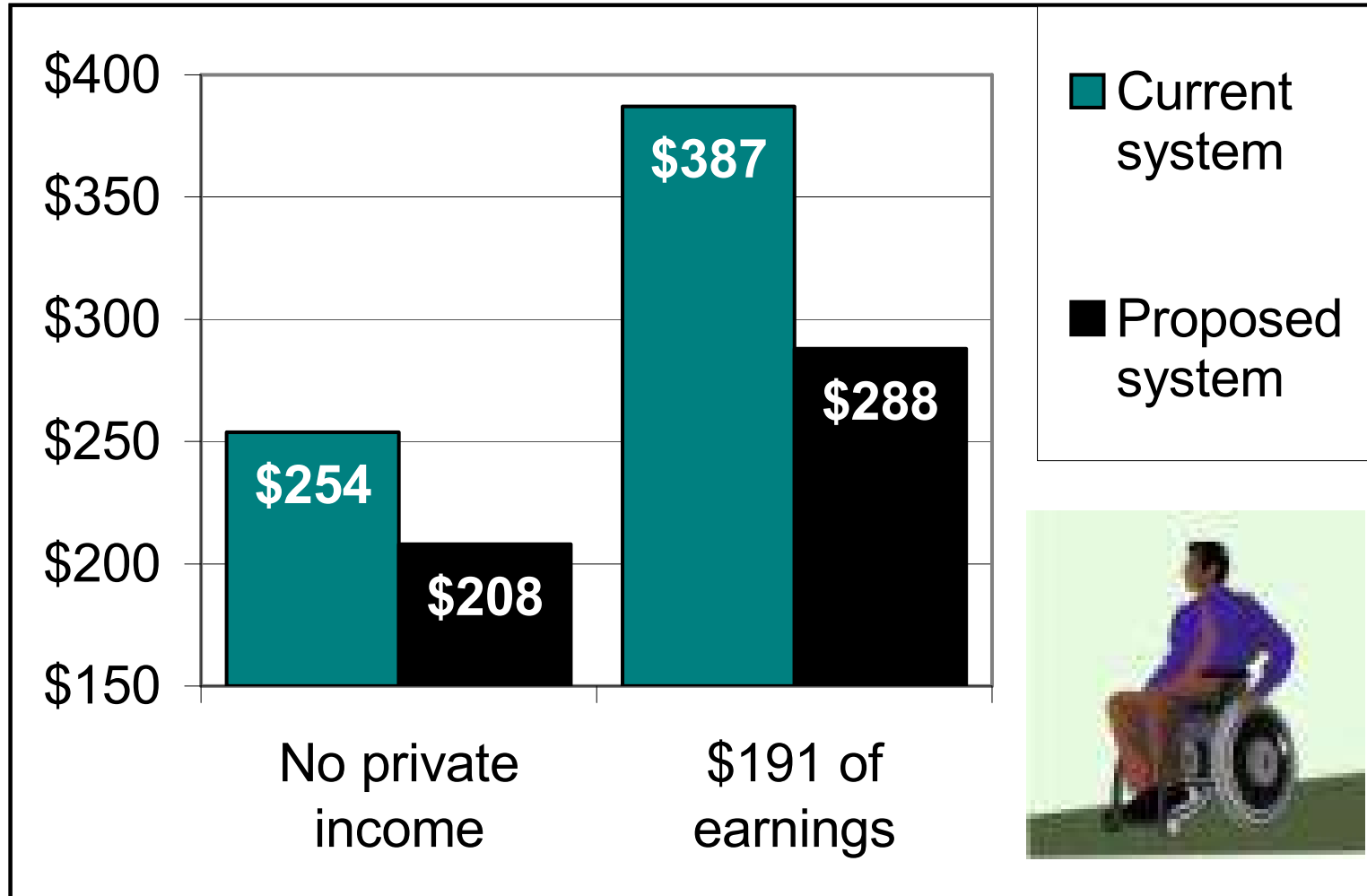
- Those on disability support pension (DSP) before 1 July 2006 generally to remain on 'pension'
- Those with disabilities applying after 1 July 2006 who are assessed as being able to work 15-29 hours a week to be placed on Newstart (or YA)
- Newstart has lower payment rate, harsher income test and is taxable
- Following modelling was done prior to introduction of the changes, so 'current policy' means pre July 2006 world and 'proposed policy' means post July 2006 world for affected recipients

EMTRs of single person with disabilities 2006-07*



* EMTR of 65% means that person keeps 35 cents from an additional dollar of earnings

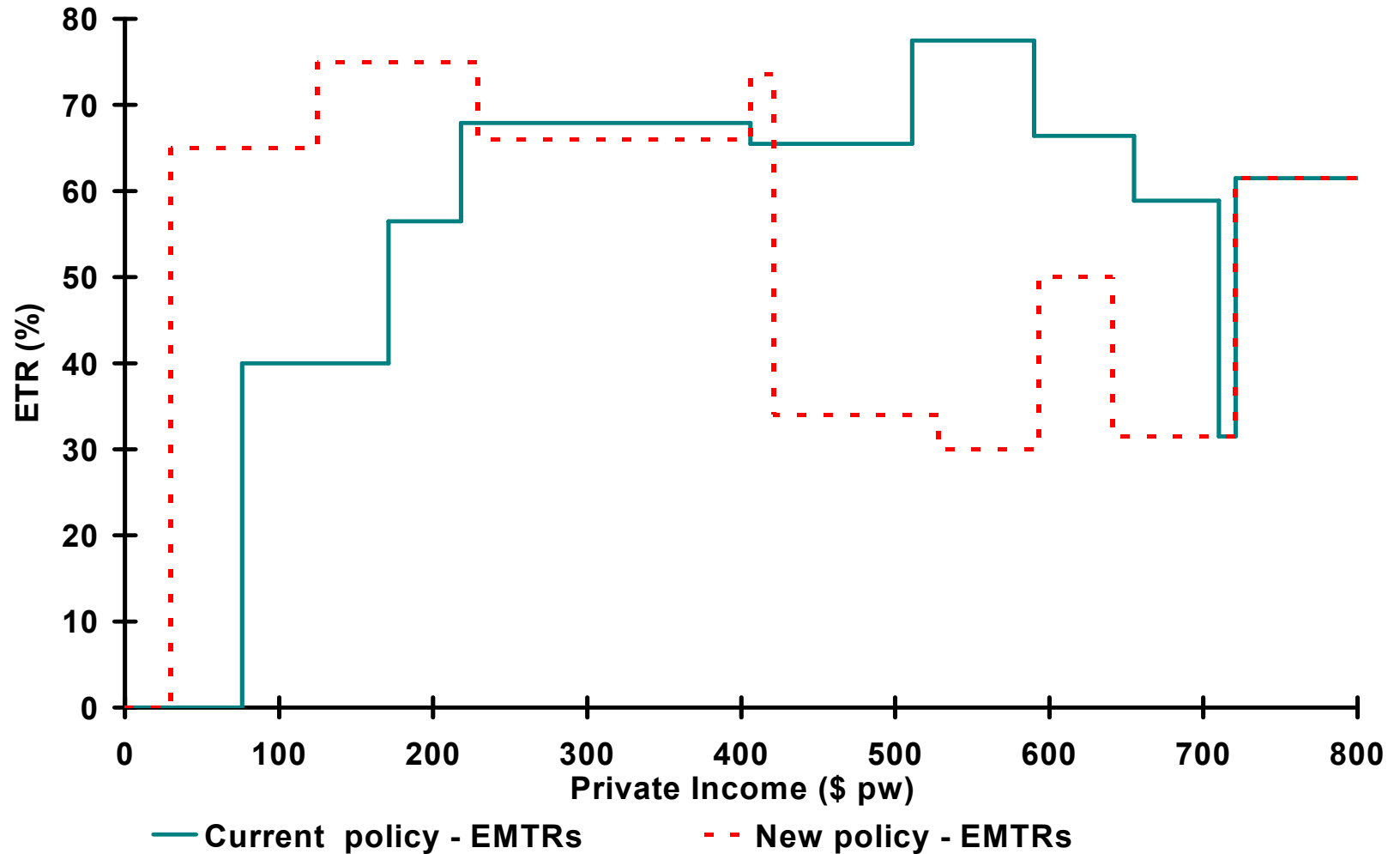
Lower take home incomes for people with disabilities



Welfare to Work Reforms: Which sole parents affected?

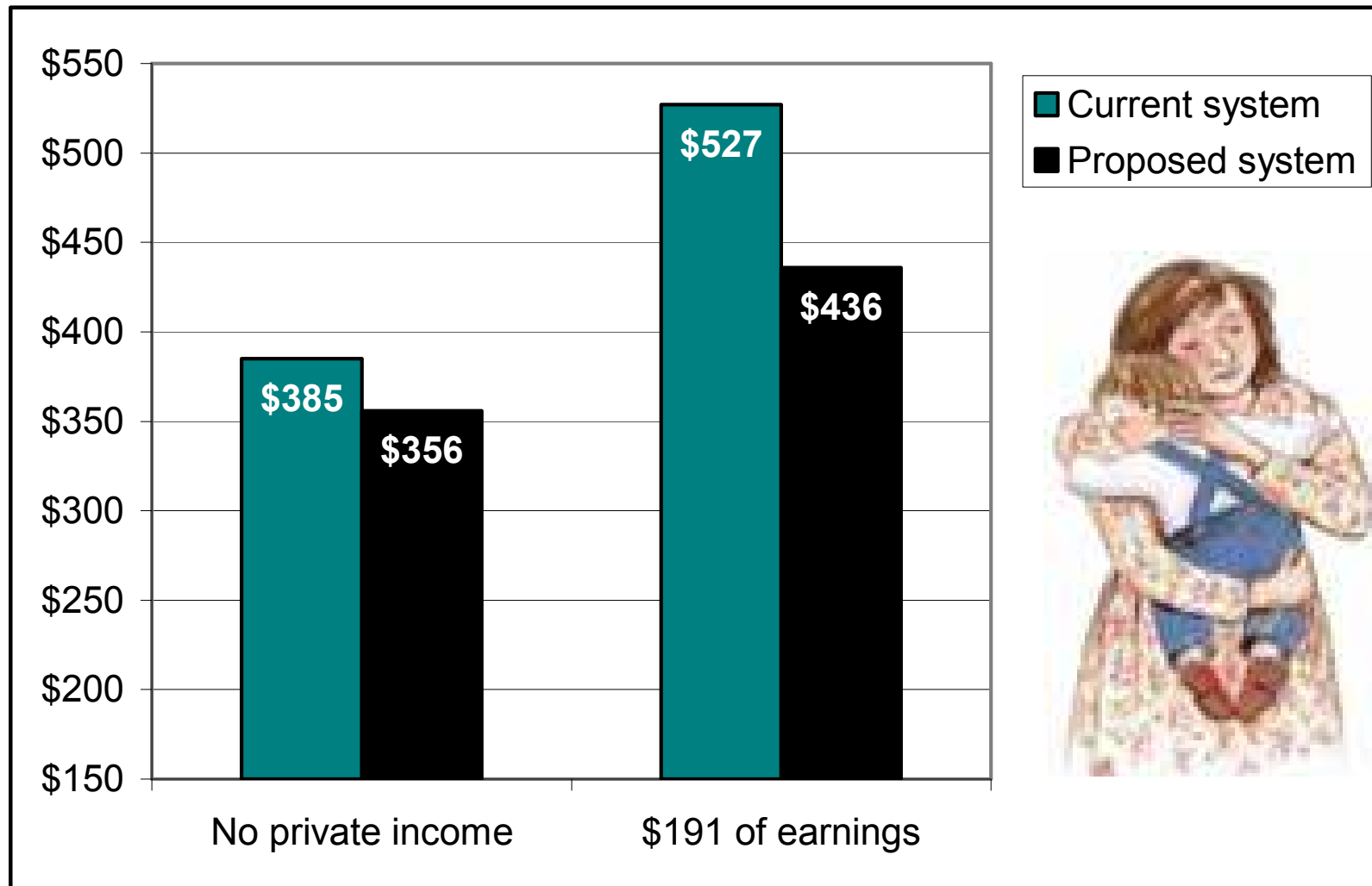
- Those on Parenting Payment Single before 1 July 2006 remain pensioners
- Those commencing after 1 July 2006:
 - Go on PPS if youngest child aged < 8 years
 - Moved onto Newstart when youngest child turns 8
 - Start on Newstart immediately if youngest child aged 8 yrs +
- Following modelling was done prior to introduction of the changes, so 'current policy' means pre July 2006 world and 'new policy' means post July 2006 world for affected recipients

EMTRs of sole parents with one child aged 8+, 2006-07 *



* EMTR of 65% means that person keeps 35 cents from an additional dollar of earnings

Lower take home incomes for sole parents with 1 child 8yrs+, 2006-07



Conclusions

- 7.1 % have EMTRs of 50% or more, more than one decade ago
- Mothers more likely to face high EMTRs
- High EMTRs have shifted up the income scale, partly due to expansion of family payments
 - 7 in every ten with high EMTRs are in the middle 40% of the income distribution
- Newstart regime produces relatively low returns from paid work (high EMTRs)
- If sole parents and disabled people affected by W2W only find part-time work, they will face 'poverty traps'
 - Keep \$80 from \$191 of earnings
 - Govt keeps other \$111
- Need to see evaluation of welfare to work changes

References

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