Stage three tax cuts make it a fairer system

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The stage three tax changes should go ahead in full from July 1, 2024, as was originally scheduled in the broader package of income tax changes introduced in the 2019-20 budget. They should be seen in the context of being part of the 2019-20 budget measures that extended income tax changes that had been announced in the 2018-19 budget.

Importantly, the stage three tax changes will lower marginal tax rates for everyone with annual earnings of between $45,000 and $200,000. This will improve work, investment and saving incentives when Australia needs to sharpen our productivity performance.

Unusually, the 2019-20 tax changes have received a mandate at the past two federal elections. The promises behind these mandates should be honoured because of the importance of trust and keeping faith and because they make good policy sense.

There are concerns at the apparent unfairness of the stage three tax changes. These concerns require serious attention. It is critical to acknowledge that the first two stages of the 2019-20 package and indeed the changes announced in the 2018-19 budget concentrated benefits on lower and middle-income earners. All of these measures have been fully in place from July 1, 2020, after the stage two changes were brought forward from their originally scheduled start date of July 1, 2022. The stage two tax changes remain in place.

In the 2019-20 budget, detailed attention was given to the distributional implications of the package of tax changes legislated with the 2018-19 and 2019-20 budgets. This analysis showed that the share of personal income tax paid by high-income earners would be very similar before and after the full package was in place. A major contributor to this outcome is that the top tax rate of 45 per cent would remain unchanged but would apply to taxable incomes above $200,000 a year instead of the $180,000 level in place in 2017-18, and that still applies.

The distributional analysis undertaken by Treasury compared personal income tax paid in 2017-18 with the estimated tax paid in 2024-25. According to that analysis, the top 1 per cent of taxpayers would pay 17 per cent of total income tax in 2024-25 compared with the 16.7 per cent of personal income tax paid in 2017-18. The top 20 per cent of taxpayers were anticipated to contribute 59.5 per cent of personal income tax in 2024-25 compared with the 60.6 per cent share of personal income tax contributed by the top 20 per cent of taxpayers in 2017-18. This is far from an intolerable shift in the distribution of income tax.

Another aspect of the fairness issue is that in large part the personal income tax changes set out in the 2019-20 budget offset previous and prospective impacts of fiscal drag and bracket creep on taxpayers. Fiscal drag methodically raises average tax rates even when real incomes are not rising. Removing the impacts of inflation-driven fiscal drag for taxpayers all along the income distribution is a clear positive for fairness.

Perhaps the most important structural change to income tax arrangements if the stage three tax changes are delivered as promised would be that most taxpayers would pay income tax at a rate of no more than 30 per cent on extra income earned.

In addition to the improved work, saving and investment incentives this shift would represent, this structural improvement also would remove a large proportion of the distortions, tax planning opportunities and complexities of tax administration that occur when marginal personal income tax rates are higher than the standard rate of company tax. To secure these benefits while retaining the progressivity of the personal income tax changes would represent a major achievement.

Of course the stage three tax changes should be delivered in full and to do so would complete an important step forward for Australia’s personal income tax arrangements.