



THE UNIVERSITY OF
SYDNEY

Faculty of Law

HENRY TAX REVIEW

Crawford School of Public Policy, ANU
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Patricia Apps
University of Sydney, ANU, UTS and IZA

My comments will focus on:

- 1 Simplified Personal Income Tax (PIT) scale
(Recommendation 2)
- 2 Single family payment per child withdrawn on family income (Recommendations 90 & 91) + the PIT scale and the resulting joint income tax system for families
- 2 Consumption rather than income as a tax base

SIMPLIFIED PIT SCALE

Review recommends a simplified PIT scale that has a “*high tax-free threshold with a constant marginal rate for most people [...]*”.

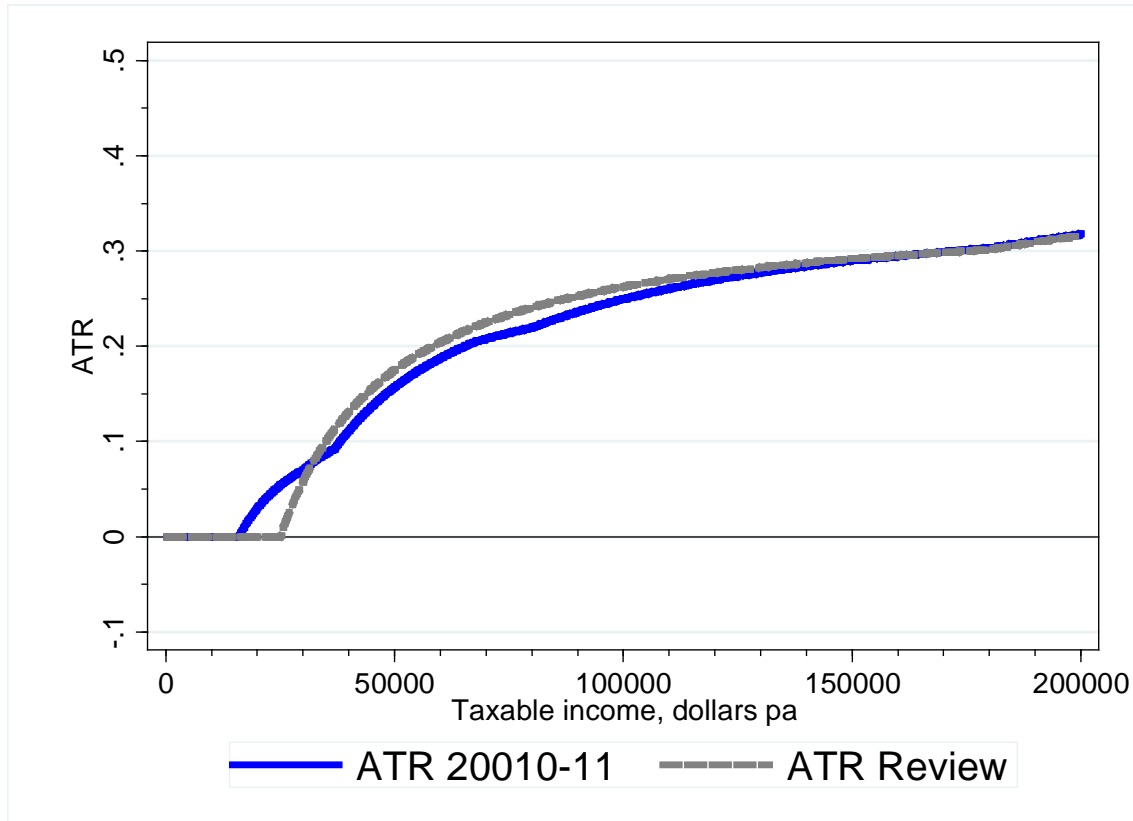
Proposes a three bracket scale: zero rated threshold of up to \$25,000, 35 cent rate up to 180,000 and a top rate of 45 cents.

Scale raises 2010-11 zero-rated threshold from \$16,000 to \$25,000

However, scale is less progressive than the 2010-11 PIT+LITO scale across middle and upper end of the distribution of taxable incomes.

SHIFT IN TAX BURDEN TO THE MIDDLE

(from around \$32,400 to \$163,500)



Simplified rate scale: a more transparent approach to shifting the tax burden towards average wage earners than using the LITO to raise middle tax rates while simultaneously lowering tax rates on higher incomes.

NEED A MORE PROGRESSIVE INCOME TAX

Apps, Long and Rees (2011) <http://ftp.iza.org./dp6007.pdf> show :

- Optimal rate structure of a piecewise linear income tax (PIT+LITO) depends on the shape of the wage distribution. For distributions that are relatively flat up to around the 90th percentile and then rise steeply, as in Australia, optimal tax structures are consistently progressive for plausible wage elasticities.
- Over the past few decades, with rising wage and earnings inequality, the rate structure should have become more, not less, progressive, contrary to the Review's recommendations.

SINGLE FAMILY PAYMENT PER CHILD WITHDRAWN ON FAMILY INCOME

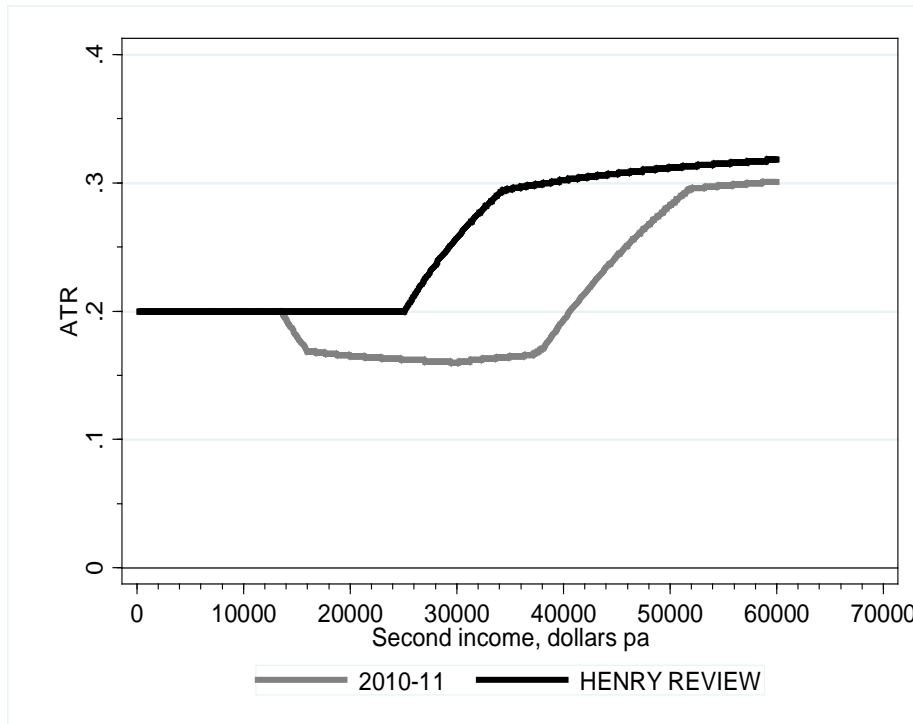
Switching from universal to family income tested child payments system is a less than transparent policy mechanism for:

- (i) changing the tax base from individual to joint income
- (ii) replacing a progressive PIT scale with an inverted U-shaped scale

This is the legacy of the previous government. Most families now face a system of joint taxation with the highest MTRs on middle incomes.

Review's proposed family payment system consolidates this system. MTRs and ATRs rise for many average wage families because the "simplification" involves withdrawing the Base Rate of FTB Part A immediately following the full withdrawal of the Maximum Rate up to the Base Rate.

Example: two children under 13, primary income = \$60,000.
At second income = \$35,000: 2010-11 ATR = 17%. Review ATR = 28%.
MTR rises from 19 to 55 cents in the dollar.



Joint taxation: high tax rates on married mothers as second earners have strong negative effects on female labour supply over entire life cycle.
Average hours of partnered females aged 25-59 \approx 50% of male hours.

JOINT TAXATION VIOLATES HORIZONTAL EQUITY

Data show a high degree of heterogeneity in parental child care vs. labour supply and bought-in child care across families with the same earning capacities and demographic characteristics.

Consider two household types:

- **Type H1:** single-earner in full time work on \$100,000, with second partner providing full time parental child care and related services
- **Type H2:** both parents working full time, each earning \$50,000 and buying in child care and related services.

Wide variation in untaxed household production between types. But joint taxation treats them equally.

SUPERIORITY OF PROGRESSIVE INDIVIDUAL TAXATION

A strongly progressive individual-based labour income tax, with universal family payments, can achieve a greater degree of vertical and horizontal equity, and at a lower efficiency cost due to lower MTRs on second incomes, than a joint income tax system.

Horizontal equity gain: **Type H1**, with a higher level of untaxed household production, pays more tax than **Type H2**.

Efficiency gains from lower MTRs on female labour supply include a higher level of household saving: Saving tracks female labour supply.

Much of household saving is that of two earner families across the middle of the primary wage distribution.

SUPERIORITY OF A LABOUR INCOME TAX OVER A CONSUMPTION BASED TAX

Review is in favour of shifting from income to consumption taxation.

However, a well designed labour income tax will always be superior to a consumption based tax because it is a less constrained policy instrument: individual rather than joint taxation.

Individual earnings can be observed and taxed progressively, whereas individual consumptions cannot be observed.

We can never observe **whose** consumption has been reduced to fund a household's saving

A broad based consumption tax is inevitably a flat rate joint tax.

CAPITAL INCOME TAXATION

Review proposes taxing income from saving (excluding owner occupied housing and superannuation) and rental property under the PIT scale but with a deduction of 40%.

Whether the revenue shortfall is met by raising taxes on labour income or on consumption, the net effect will be higher rates on the second income.

The data indicate that the labour supply effects of high MTRs on the second earner may have a very significant negative effect on saving, far more so than a tax on saving directly or a tax on capital income.

CONCLUDING COMMENTS

- Female labour is arguably the most mobile factor of production in the economy, because of its high degree of substitutability with household production in the form of parental child care.
- OECD countries with family tax systems that do not discriminate as heavily against the second earner have higher female labour supplies, in the order of 50% higher in the case of Sweden.
- The same countries can also be expected to have higher levels of saving (as opposed to saving rates) and a more sustainable tax base with population aging.
- Piketty and Saez - capital tax rates as high or higher than those on labour income may make sense.