Income tax weighing down the Australian family budget
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About the Author

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Summary

- The federal government should not increase the Medicare Levy, since Australian households are already spending more of their incomes in income tax than on basic necessities.

- Adjusted for price inflation, income tax payments took away 13 per cent of household gross incomes in 2014, compared against six per cent in 1960.

- As the income share taken in income tax has doubled since 1960 the relative share of essential spending, such as housing costs, food, clothing, health care, transport, and utilities, has fallen by between four and nine percentage points.

- Growth in income taxes of 1,332 per cent since 1960 have outstripped gross income growth of 589 per cent, as it has for most essential spending items.

- Australian income taxes are increasingly being shouldered by fewer households, with distributional analysis showing families on higher incomes are paying the bulk of the income tax.
Introduction

In recent months there have been several suggestions to increase the burden of taxation on Australian families and businesses, as part of efforts to help reduce the severity of budget deficits incurred by federal and state governments.

One of the most prominent tax raising proposals is an increase in the Medicare Levy, currently an effective ‘surtax’ of two per cent on personal incomes over a certain threshold amount.

In advance of a recent leaders’ retreat of commonwealth and state governments over reforming the federation, the Premiers of Victoria and Queensland expressed support for raising the Medicare Levy to help fund health spending. At the conclusion of the Retreat the Prime Minister, Premiers, and Chief Ministers ‘agreed to keep commonwealth and state tax changes on the table including ... the Medicare Levy.’

More recent indications have been that governments are considering doubling the Medicare Levy, which would raise an additional $14 billion in annual revenue and lead an average working family to pay an additional $2,000 per annum.

A doubling of the Medicare Levy would increase Australia’s effective top personal income tax rate to 51 per cent, moving up to the top five income tax rates in the world. The proposal would also increase the national average tax burden (proxied by the taxation to GDP ratio), estimated by the Institute of Public Affairs in 2013 to be 34.3 per cent compared with the OECD average of 33.7 per cent.

Another way to look at the income taxation burden is to compare income taxes paid by households against the basic cost of living, represented by household spending on essential items such as food, clothing, housing, health care, and on utilities.

The analysis presented here shows that Australian households are already paying more of their income in income tax than they do on basic necessities, meaning extra income tax hikes (specifically, via the Medicare Levy) will only worsen cost of living pressures.
The average Australian household is paying more in taxes than on basic necessities

It is possible, using Australian Bureau of Statistics national income accounting data, to track the long term trend in the total amount of income tax payable by households and compare this against similar trends in household consumption spending (Table 1).

Up to the early 1970s real income tax payments by households were lower than real spending on food and transport. Since that time, income taxes exceeded expenditures on these, and other essential items, to become in itself the most significant item in household budgets.

In 1960 about six per cent of real total gross incomes earned by Australian households went to the federal government in the form of income tax. This had effectively doubled by the end of the Whitlam era characterised by an enormous increase in social, and other, forms of government spending. By the time of the GST reform in 2000, the share of income absorbed by income tax reached a high point of 16 per cent, before receding somewhat to about 13 per cent in 2014.

Income taxes have assumed a greater share of the household budget, crowding out spending on essentials such as housing costs, food, clothing, health care, transport, and utilities. For housing owner occupiers, the gross income share of consumption items fell from about 35 per cent in 1960 to about 32 per cent in 2014. The gross income share of consumption items for tenants fell from about 33 per cent to about 24 per cent during the same period.

Overall, the percentage growth in income taxes from 1960 to 2014 was about 1,332 per cent. By comparison the growth in gross incomes in percentage terms were 589 per cent. Income tax growth also exceeded the growth in individual spending items with the exception of imputed owner - occupier rental housing costs (1,754 per cent).
Table 1: Income tax and selected essential expenditures of Australian households, $ billions

<table>
<thead>
<tr>
<th></th>
<th>Total gross income</th>
<th>Income tax</th>
<th>Owner-occupier housing rent (imputed)</th>
<th>Transport</th>
<th>Food</th>
<th>Health</th>
<th>Tenant housing rent (actual)</th>
<th>Utilities</th>
<th>Clothing</th>
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<td>19</td>
<td>11</td>
<td>21</td>
<td>26</td>
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<td>4</td>
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<td>7</td>
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<td>84</td>
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<td>38</td>
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</table>

Figures are adjusted for price inflation. All spending items include indirect taxes and transfer payments. Owner-occupier housing rent includes household spending by owner-occupiers on rates, mortgage interest, insurance, repairs, maintenance and similar expenditures. Transport includes household spending on purchase and operation of vehicles, and transport services. Utilities include household spending on electricity, gas, water, and sewerage.

Source: ABS, Australian System of National Accounts, cat. no. 5204.0; ABS, Consumer Price Index, Australia, cat. no. 6401.0.
Fewer households are shouldering more of the nation’s income tax bill

Although the analysis presented above provides a useful illustrating of changes in cost pressures faced by Australian households, on aggregate, over time, it should be recognised that the nature of Australian households has changed as well as the distribution of income and consumption spending at the household level.

Australian economist Sinclair Davidson has undertaken extensive analysis of the income tax shares paid by various income brackets. Drawing from Australian Taxation Office data, Davidson illustrates that the top quartile of taxpayers paid a substantial, and growing, share of net income tax (that is, income tax less deductions) liabilities since the second half of the 1990s. The respective shares paid by the bottom 25 per cent, and the middle 50 per cent, have each fallen (Figure 1).

Figure 1: Net income taxation paid by various income cohorts, Australia

Source: ATO, Taxation Statistics (provided by Sinclair Davidson).