Research Note: Distributional Modelling of Labor Tax and Child Care Payment Election Policies[1]

Associate Professor Ben Phillips, Professor Matthew Gray, Richard Webster, Cukkoo Joseph

ANU Centre for Social Research and Methods

14 May 2019

Contents

1. Introduction

This research note presents estimates of the distributional impact of Labor's 2019 Federal election tax policy for Australian households by disposable income and household wealth. It also considers the impact of Labor's child care policy. Labor policies are compared with the current policy settings as outlined in the 2019-20 Federal Budget.

The policies modelled are: dividend imputation; capital gains; negative gearing; the reinstatement of the Budget Repair Levy; changes to the Low and Middle Income Tax Offset; personal income tax rate and threshold settings; taxation of trusts; and changes to the Child Care Subsidy.

The impact of the Labor election policies for each year between 2018-19 and 2029-30 has been estimated using PolicyMod (our detailed microsimulation model of the Australian tax and transfer system). Benchmarking data from the Parliamentary Budget Office has been used to improve the accuracy of the aggregate estimates.

For simplicity, the results are presented in this paper in 2019 dollars. Several Labor policies involve grandfathering such as negative gearing and capital gains tax changes. The modelling assumes that all the policies are 'mature' in the sense that no grandfathering applies. Our numbers are consistent with Parliamentary Budget Office estimates.

2. Policy Changes

This section describes the Labor election policies considered in this paper.

Changes to dividend imputation

The Labor policy is to no longer allow taxpayers to receive a cash refund for excess imputation credits. Under the Labor policy taxpayers will continue to be able to use imputation credits to reduce tax.[2]

The Labor policy would apply from 1 July 2019 and will only apply to franked dividends earned from the 2019-20 financial year onwards. Groups that will be exempt from the policy change and continue to be able to receive a cash refund for excess imputation credits are:
- Recipients of an Australian Government Pension or Allowance; and
- Self-managed Superannuation Funds (SMSF) with at least one recipient of an Australian Government Pension or Allowance as at 28 March 2018.

SMSFs with at least one recipient of a Pension or Allowance established after 28 March 2018 or SMSFs established prior to 29 March 2018 that did not have at least one recipient of a Pension or Allowance will not be able to claim excess imputation credits as a cash refund.

---

[2]   Information on the Labor dividend imputation credit policy is sourced from
https://www.chrisbowen.net/media/183744/180604-updated-factsheet-dividend-imputation.pdf
[accessed 30 April 2019]

Capital gains and negative gearing policies

The Labor policy is to substantially limit the circumstances under which negative gearing can be used. The policy is that from 1 January 2020 negative gearing will be limited to investments in newly constructed housing investments. All investments made prior to this date will not be affected by the changes (i.e., the changes will be fully grandfathered). [3]

Under the current tax system any capital gains made following the disposal of a non-exempt asset is subject to Capital Gains Tax. If an asset has been owned for at least one year then only half of each capital gain is added to taxable income and taxed at an individual's marginal rate. The Labor policy is to reduce the capital gains discount from 50% to 25% for newly-purchased assets held for more than a year, meaning that for those assets three quarters of each gain will be taxed instead of one half. [4] Under the policy all investments made prior to 1 January 2020 will be fully grandfathered. Under the Labor policy the changes to the CGT discount will not apply to superannuation funds or to the 50 per cent active asset reduction concession that applies to small businesses.

Budget Repair Levy reinstatement

The Labor policy is to reinstate the Budget Repair Levy, a 2 per cent levy on each dollar of income above $180,000 per year of taxable income.[5] This would take effect from 1 July 2019 and would remain in place until the budget surplus is equal to 1% of GDP which Labor are projecting to occur in 2023-24. We continue the Budget Repair Levy up to and including 2022-23. Since our presented results here are for the long-term we do not include this measure in the results.

Low and Middle Income Tax Offset (LMITO)

The 2019-20 Budget provides:

(1) a tax offset of up to $255 for taxpayers with taxable income of $37,000 or less. Between $37,000 and $48,000, the value of the offset increases at a rate of 7.5 cents per dollar to the maximum benefit of $1080. Taxpayers with taxable incomes from $48,000 to $90,000 will be eligible for the maximum offset of $1080. From $90,001 to $126,000, the offset will phase out at a rate of 3 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 to 2021 financial years only.

(2) In the 2019-20 Budget, from 2022-23 the Low Income Offset increases from $445 to $700 and the personal income tax bracket for the 19 per cent rate extended to $45,000

---

[3]   Information on the Labor negative gearing policy is sourced from
        https://www.alp.org.au/negativegearing [accessed 30 April 2019]
[4]   Information on the Labor capital gains policy is sourced from https://www.alp.org.au/negativegearing
        [accessed 30 April 2019]
[5]   The Budget Repair Levy was in effect from 2014-15 to 2016-17.

from $37,000. LITO withdrawn at 5 per cent between $37,000 and $40,000 and then removed at current 1.5 per cent rate.

The Labor policy includes only the changes in (1) with the exception that the base amount will be $350 rather than $255 per year and some minor adjustments to the related tapers.[6] The Labor offset remains for all years into the future. For our long term modelling we increase this offset with wages for each year from 2023-24.

Personal income tax rates and thresholds

The 2019-20 Budget increases the 32.5 per cent tax rate threshold from $90,000 to $120,000 in 2022-23. From 2024-25 the 32.5 per cent tax rate threshold is extended to $200,000 and the rate reduced to 30 per cent. The top rate of 45 per cent applied beyond that threshold (up from the previous $180,000). The Labor policy is to not implement these 2019-20 Budget changes to tax rates and thresholds.

Trust Taxation

The Labor Party is proposing to increase taxation on trusts by ensuring that most trusts attract a minimum tax rate of 30 per cent.

Child care payment policy

The Labor child care payment policy is to increase the rate of subsidy of child care from 85 per cent to 100 per cent up to the current hourly fee cap for families earning up to $69,000 per annum who meet the current activity test. For families with an income of over $69,528 to $100,000 the child care subsidy rate will taper from 100% to 85% and for families with an income of $100,001 to $174,526 the child care subsidy will taper from 85% to 60%. This policy increases the level of child support assistance for these families.[7]

3. Methodology

ANU PolicyMod model of the Australian tax and transfer system has been used to undertake microsimulation analysis of the estimated impact of the Labor tax and child care payment policies. PolicyMod is based on the 2015-16 ABS Survey of Income and Housing. The survey has been adjusted to better reflect the population of 2018-19 and beyond using a range of administration data and official statistics. This means that the underlying PolicyMod database for each year over the forward estimates and beyond is adjusted to ensure the population totals and distributions and dollar values better represent current and future years. The model simulates the current policy settings of most of the tax and transfer system in Australia. In this paper we simulate the proposed tax and child care payment changes and apply the assumptions in the Federal Budget around wage and price changes through to 2029-30. The proposed Labor policy is compared with the 2019-20 Federal

---

6   Information on the Labor Low and Middle Income Tax Offset policy is sourced from https://www.alp.org.au/policies/fairer-tax-cuts-for-working-australians/ [accessed 30 April 2019]

7   Information on the Labor child care policy is sourced from https://www.alp.org.au/policies/labors-plan-for-cheaper-child-care/ [accessed 14 May 2019]

Budget policy settings in order to estimate the overall fiscal impact of the policy change and the distributional impact for Australian households.

The distributional analysis is based on a comparison of the 'base world' which is the policy settings of the 2019-20 Federal Budget with the 'alternative' world of the Labor planned policy changes. For each household, disposable household income is calculated under both the base (2019-20 Federal Budget) and alternative Labor policies. The difference in disposable household income between these two scenarios is the estimate of the effect of the Labor policies on each household. The results at the individual household level are combined to estimate the impact of the election policies on all households or for household groups, such as income. This analysis is undertake for each year from 2018-19 to 2029-30.

For simplicity we present the results of the 'mature' policies but in 2019 dollars. This means that for Labor we have assumed that they make no changes to their tax thresholds and rates within the forward estimates (to 2022-23) but bracket creep is returned through increases in tax thresholds beyond the forward estimates. This approach aligns with the Labor promise to maintain a fixed tax to GDP ratio beyond the forward estimates. The approach is also the standard method used in prior *Intergenerational Reports* (IGR) when considering personal income taxation beyond the forward estimates. We also apply the IGR assumptions for bracket creep to the 2019 Budget settings of the Coalition Government beyond their 'Seven Year Tax Plan' from 2024-25.

The modelling presented in this paper does not impose or estimate any behavioural change that may occur 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.[8] Our estimates of the impact of the Labor franking credit, negative gearing and capital gains policies are benchmarked to the PBO estimates and because the PBO does factor in some behavioural change we have indirectly included these impacts such as changes in investor behaviour, moving funds from non-taxable to taxable sources in the case of franking credits and changes to hours worked. We acknowledge that such impacts are all uncertain and subject to considerable debate.

Our modelling only considers the direct financial impact of policy change. Under the Labor policy changes the average tax rate will increase. Presumably this additional revenue will either be used to increase expenditure in other areas of government or used to pay down government debt. The impact on households from additional government expenditure is not accounted for in this analysis.

Franking credits are generally received via either the personal income tax system (e.g., though domestic shares), self-managed superannuation funds (SMSF) or Australian Prudential Regulation Authority (APRA) regulated superannuation funds. The largest source

---

[8]   Estimating the behavioural impacts requires complex econometric modelling beyond the scope of this paper. Such modelling tends to only tell a partial story with changes in workforce participation note necessarily being modelled alongside labour force demand. It is also the case that behavioural modelling can lead to double counting of the policy impact as broad budget assumptions such as wages growth and employment growth already account for behaviour and economic change in response to policy change.

of franking credits is via SMSFs. To enable distributional modelling here we imputed the franking credits based on the aggregate PBO costing data, PolicyMod individual superannuation balances and type of superannuation fund and the age of the superannuant. The modelling in this paper was also aligned with aggregate statistics on SMSFs from the ATO. This data includes detailed demographic and distributional information regarding SMSF's and the distribution of fund size and the share of funds with investments in Australian shares – which usually provide fully franked dividends. The ATO summary statistics for SMSFs was for 2016-17. This data has been "aged" for future years in PolicyMod.

Our modelling excludes pensioners or allowees as the Labor policy provides a 'pensioner guarantee' that ensures that a single person or couple who are in receipt of either a pension or allowance will still be able to claim franking credits. Estimated franking amounts have been adjusted down modestly on account of changes to the superannuation system where earnings are taxed at 15% on earnings accrued from balances above the $1.6 million cap for singles and $3.2 million for couples.

The negative gearing policy is straightforward to model in PolicyMod which is already benchmarked to ATO tax stats for rental investors. An assumption that we have made is that 20 per cent of investors will not be impacted as they invest in newly constructed dwellings. Although ABS Housing Finance statistics suggest the share of investment in new housing is considerably lower than 20%, the ABS estimate does not include all new housing and is generally considered to be an under-estimate (ABS 2018). The assumed share of investment that is newly constructed dwellings is unlikely to impact upon the distributional analysis because our analysis assumes a random allocation of the 80 per cent who are expected to invest in existing properties over the longer term. We effectively assume that the income distribution and demographic profile of persons who invest in new and existing properties are the same.

The ABS Survey of Income and Housing, which is used as the basis for the PolicyMod population basefile, does not provide information on capital gains. We therefore have used the Australian Tax Office (ATO) 2 percent individual taxation file as the basis for imputing capital gains onto the PolicyMod base data set. The first step involves using a logistic regression model to estimate the factors associated with claiming capital gains income using the ATO two per cent sample file. The coefficient estimates from this model are then used to determine (impute) which households in the PolicyMod basefile claim capital gains income. The second step involves estimating a linear regression model of the factors associated with capital gain amount using the ATO two per cent sample file. The coefficient estimates from this model are used to determine the amount of capital gains received by households in the PolicyMod file. The ATO 2 per cent tax file provides a limited range of variables for such modelling including age, sex, taxable income, non-salary income and welfare payment income.

The Budget provides a range of personal income tax cuts. Labor's election policy is to not implement some of these tax cuts. These changes are modelled using the standard PolicyMod model.

Labor proposes to increase taxes on some trust products. There is information in PolicyMod on persons with trusts and their value and this allows Labor's proposal to trust taxation policies to be modelled. A simple proportion of this value is applied in order to align our estimate with the PBO estimate of the total value of this tax increase.

A limitation of the ABS Survey of Income and Housing is that weekly superannuation income understates the incomes of retirees. There are a large number of persons in the survey who don't report a weekly income even when they are retired. A typical case could be where a person has reached the preservation age but does not withdraw regular weekly amounts – preferring non-weekly lump sums. To overcome this problem we have imputed weekly income for such persons based on minimum drawdown amounts.

4. Results

This section presents the estimated impact of the Labor election tax and child care payments policies on households.
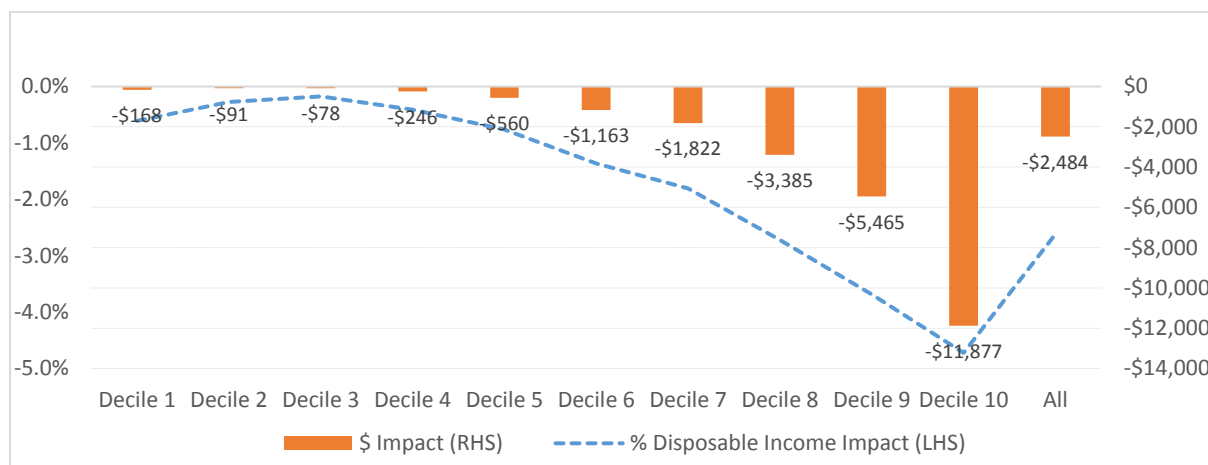
Figure 1 shows that the overall impact of all the selected Labor policies on household income by equivalised household income decile.[9] Overall, the Labor election policies (when mature) are estimated to reduce household disposable income by an average of $2,484 (in 2019 dollars). The modelling shows however that the changes have virtually no impact for households in the bottom 40 per cent of the income distribution and the largest decrease for those in the top 10 per cent ($11,877). The combined effects of the changes are thus highly progressive in their impact.

The top income decile has an average loss of disposable income of $11,877 per year under Labor compared to the 2019 Budget. For this income group this is around 4.7 per cent of disposable income. This compares to the reductions for the bottom 5 deciles of below 1 per cent.

In raw dollar terms the top 20 per cent account for around 70 per cent of the fiscal impact with a loss of disposable income of around $17 billion out of around $25 billion in increased revenue under Labor.

---

[9]   The income deciles 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.

Figure 1. Impact on Annual Household Disposable Income by Equivalised Household Income Decile, 2019 dollars
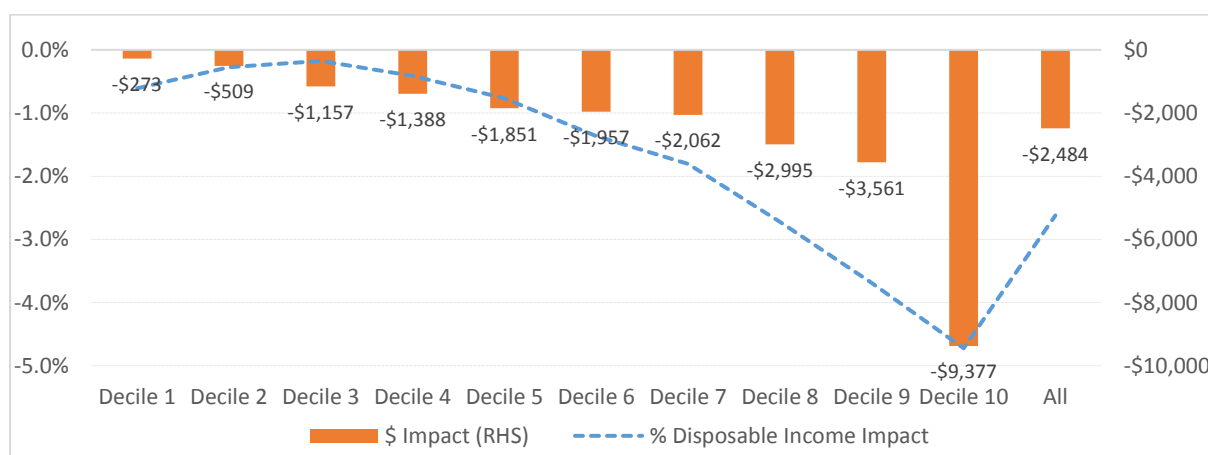

Source: PolicyMod, ANU
Notes: Decile 1 is the lowest income decile and decile 10 the highest.

When considering the impact of the Labor election tax and child care payment policies by wealth deciles[10], there is a similar pattern of impacts as for income deciles (Figure 2). The highest wealth decile experiences the largest negative income impact from Labor policies of $9,377 per year or 5.3 per cent of disposable household income. The impact across the lower wealth deciles are modestly higher than that of the income deciles but remain modest with the bottom 5 deciles also with impacts below 1 per cent of disposable income. The top 20 per cent of the wealth distribution contributes 52 per cent of the fiscal impact.

Figure 2. Impact on Annual Household Disposable Household Income by Wealth Decile, 2019 dollars

Source: PolicyMod, ANU
Notes: Decile 1 is the lowest wealth decile and decile 10 the highest.

---

10   When considering the wealth distribution it is the case that there is often not a strong relationship between wealth and income. Many low wealth households have significant incomes and likewise some high wealth households have low income. Nonetheless, it remains useful to consider the results by the wealth distribution. We find that again, the largest impact on disposable incomes is for the top wealth decile.

Table 1 shows that households in higher income households are much more likely to be worse off than a low income household as a result of the Labor election tax and child care payment policies. Around 98 per cent of the highest income decile households will be worse off compared to 7 per cent for the bottom decile households. The driver of this difference is that high income households will not receive the tax cuts planned for 2022-23 and 2024-25 in the 2019 Budget under Labor policy.

Also worth noting that most low income households are not impacted by Labor policy. These households often receive welfare payments such as the Age Pension or the Newstart payment. These households do not pay tax and rarely receive any childcare payments so no policies modelled in this paper affect them.

Table 1 Winners and Losers, Households by income deciles (equivalised household income)

Income decile	% Losers	% No Change	% Winners
Decile 1	7%	79%	15%
Decile 2	4%	85%	11%
Decile 3	14%	50%	36%
Decile 4	30%	26%	44%
Decile 5	35%	10%	54%
Decile 6	50%	7%	43%
Decile 7	63%	4%	33%
Decile 8	83%	3%	14%
Decile 9	94%	2%	4%
Decile 10	98%	2%	0%
All	48%	27%	25%

Source: PolicyMod, ANU
Notes: Decile 1 is the lowest income decile and decile 10 the highest.

It is not surprising that the Labor tax policies have the largest negative impact on higher income (and wealth) households given that the biggest changes are not delivering the 2019-20 Federal Budget tax cuts of 2022-23 and 2024-25, major reductions in the ability to negatively gear, removal of the capital gains tax discount and the loss of franking credits are policies that benefit high income and high wealth households the most.
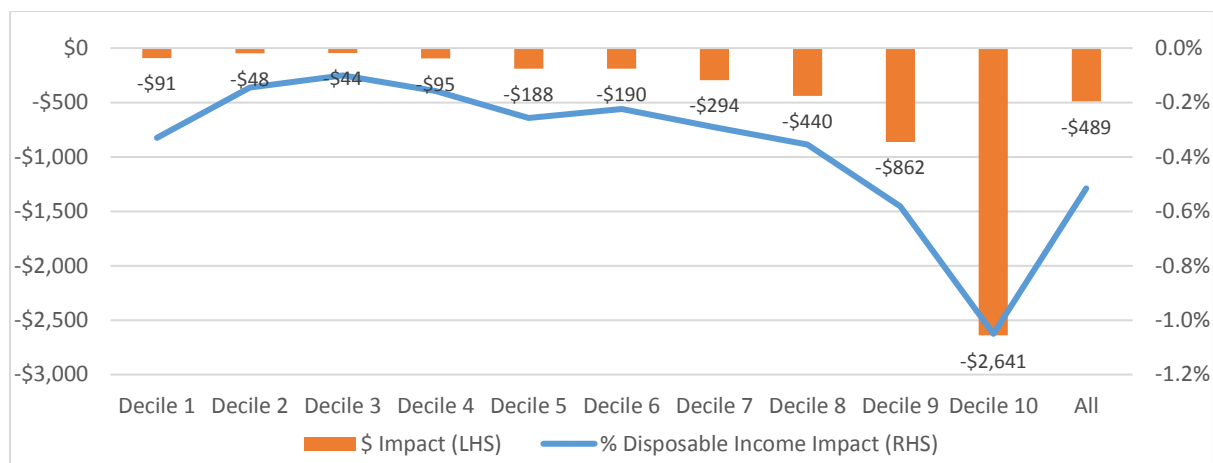
Impact of the Labor Franking Credit Policy

This section focuses on the impact of the franking credit policy change proposed by Labor. The analysis presents the impact of the policy change on household disposable income. This has advantages over analysis by personal taxable income - overcoming the issue of superannuation being mostly not taxable for those persons aged over the preservation age. The analysis also takes into account income received from superannuation which is generally not counted towards taxable income. This provides a much more realistic measure of living standards within a household than just that of personal taxable income – which for many retirees is effectively zero.

Figure 3 shows that the largest impact in dollar terms and per cent of disposable income terms is the top 10 percent (decile 10). The top 10 per cent would, on average, pay $2,641 per year (1.1 per cent

of disposable income) in more tax where franking credits are removed.[11] The average impact is $489 per year across all income groups or about 0.5 per cent of disposable income. The policy change has virtually no impact on households in the bottom half of the income distribution

Figure 3. Impact of proposed changes to franking credit policy on Annual Household Disposable Income by Equivalised Household Income Decile, 2019 dollars
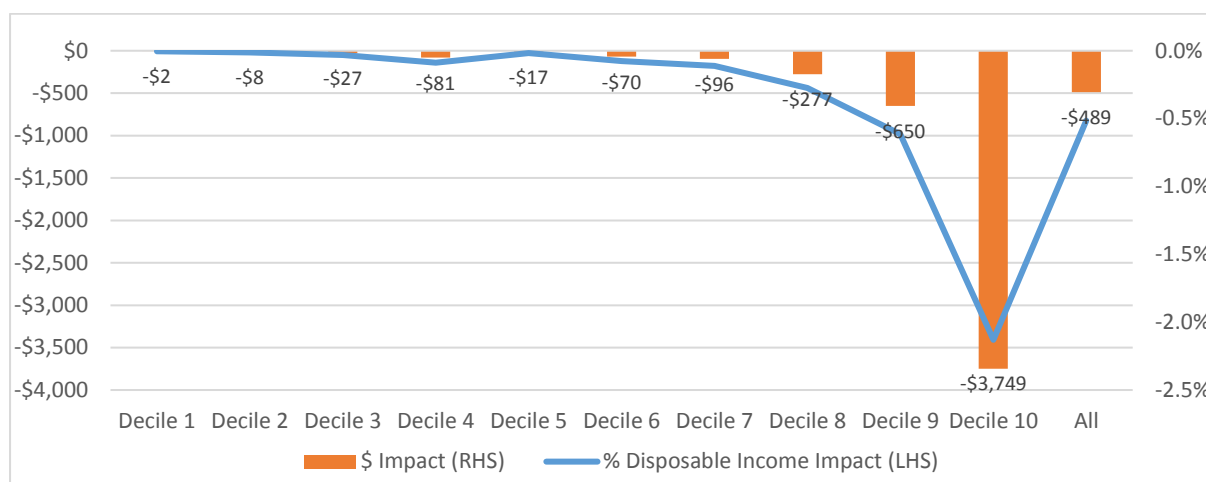

Source: PolicyMod, ANU
Notes: Decile 1 is the lowest income decile and decile 10 the highest.

The impact is even more progressive when considered by wealth distribution (Figure 4) with virtually no impact across the bottom 70 per cent of the wealth distribution. This should be no surprise as, in most cases, large franking credits are related to large incomes that flow from large superannuation balances. We estimate that around 89 per cent of all franking credits claimed are paid to the top 20 per cent of the wealth distribution. Around 2.7 per cent of franking credits are paid to the bottom 50 per cent of the wealth distribution.

---

[11] Technically many of these households are not paying less tax, rather they are no longer receiving a franking credit.

Figure 4. Impact of proposed changes to franking credit policy on Annual Disposable Household Income by Wealth Decile, 2019 dollars

Notes: Decile 1 is the lowest wealth decile and decile 10 the highest.

While the impact appears to be very small for low income and low wealth households, it may be that very few of these households are impacted but those who are have significant reductions in income. We find that overall around 6.5 per cent of households are negatively impacted (around 600,000 households) from the removal of franking credits.[12] The bottom 10 per cent of households ranked by income their share of impacted households from removing franking credit refunds is 3.6 per cent and just 1 per cent for the next 10 per cent. The top 10 per cent of income household's share is much more significant at 18.7 per cent.

In short, we find that the removal of franking credits affects around 6.5 per cent of households but the vast majority of the impact will be on households who are high income and high wealth. There are a much smaller share of low income or low wealth households impacted and for those who are the impacted that impact tends to be relatively small. As an example, for those households impacted by the loss of franking credits, the lowest wealth decile average financial impact is $686 per year compared to nearly $12,000 for the top decile.

5. Policy Alternatives

Labor's policy costings suggest that where the economy and fiscal outcomes allowed they may provide tax cuts. In our long-term model we find that Labor has around $25 billion per year additional funds relative to the 2019 Budget (in 2019 dollars). If Labor were to use half of this money to fund alternative tax cuts there are many potential ways Labor could reduce the impacts on household budgets.

Labor has committed to reviewing the Newstart Allowance and we have assumed in our alternative policy analysis they have increased Newstart by $75 per week for singles. This policy is expected to cost around $3 billion per year in the long run.

We consider two potential policies where Labor were to spend roughly half of this surplus.

---

[12]   We do not attempt to model or include APRA based superannuation funds and only imputed franking credits to persons above the age of 59 years for our long run model.

1) Higher Newstart (+$75pw) and Tax Free Threshold increased to $25,000
2) Higher Newstart (+$75pw) and Top marginal tax rate and second top marginal tax rate lowered to 36 per cent.

Both of these policies are possible within the given funding envelope. These policy simulations are not recommendations, merely provided to show the magnitude of tax cuts that could be offered.

6. Conclusion

The Labor policy provides only modest tax relief to low and middle income households being only modestly more generous than the 2019 Budget. Labor also raises significantly more revenue through maintaining tax rates and thresholds over the forward estimates (2019 to 2022 fiscal years) and removing surplus franking credits and negative gearing, and providing less generous capital gains and trusts arrangements. Labor is also increasing child care support.

We find that in the long-run the selected policies provide Labor with around $25 billion in additional revenue (minus the additional expenditure on child care) in 2019 dollars. The increases in taxation mostly impact high income and high wealth households. The bottom 50 percent of income and wealth households are largely not impacted either due to not currently paying tax or through not receiving any of the benefits that some of the tax concessions modelled here provide.

Franking credits benefit households in the top 20 percent of the income and wealth distribution considerably more than other households. While these households often have low 'taxable incomes' they tend to have large wealth balances or be in households with high incomes (even where the individual affected has a low income).

The Labor policy would increase tax revenue in a way that would mostly impact higher income and higher wealth households. Where fiscal circumstances allow Labor suggests they could provide tax cuts to offset the impacts of future bracket creep. Our analysis suggests that in addition to raising Newstart there are significant tax cut options available to Labor such as increasing the tax free threshold or reducing the top marginal tax rate, or in fact entirely removing the top tax rate of 45 cents in the dollar.

References

Australian Bureau of Statistics, *Housing Finance Statistics,* November 2018*, Table* 11

The Commonwealth of Australia, *Intergenerational Report 2015.*