

Bracket creep vs stage 3 tax cuts

Taxpayers have already been overcompensated for bracket creep with high income earners being the most overcompensated. The government proposed stage 3 tax cuts will simply add to the overcompensation

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Bracket creep is not a problem in Australia because Governments over the last 18 years have cut income tax by larger amounts than the increase in tax caused by bracket creep. Put simply Australian taxpayers have been over compensated for bracket creep.

If the Government's proposed tax cuts are not legislated, then all income levels will still be overcompensated for bracket creep by 2024-25. This means if there are no additional tax cuts over the next five years, bracket creep will still be less than the size of income tax cuts that have occurred over the last 18 years.

MEASURING BRACKET CREEP

To measure bracket creep, it is important to look over a long time period. This is because measuring bracket creep over a period that has not seen a tax cut will exaggerate the impact of bracket creep and measuring bracket creep over a period where there has been a recent tax cut will reduce the impact of bracket creep. To avoid this problem, it is important to include as larger time period as possible in order to capture both periods where income taxes have been cut and periods where it has not been cut.

The furthest back that it is possible to go is 2001 because the income tax cuts immediately before this were in compensation for the introduction of the GST.

If we index tax thresholds to the CPI since 2001 we can create a baseline for tax that would be collected without any bracket creep. If we then compare current tax rates or

proposed future tax rates with our bracket creep baseline, then we can determine if the impact of bracket creep or income tax cuts has been greater. If the amount of income tax collected from our bracket creep baseline is greater than the actual amount of tax collected, then we know that taxpayers have been over compensated for bracket creep. That is, they have been given back in tax cuts more than bracket creep has taken.

If the amount collected from our bracket creep baseline is less than the actual amount collected, then we know that taxpayers have not been fully compensated from bracket creep. That is, they have been given back in income tax cuts less than bracket creep has taken.

Table 1 shows compares the tax rates and thresholds of the bracket creep baseline with the tax rates and thresholds in 2024-25 if the Government’s tax plan is legislated in full.

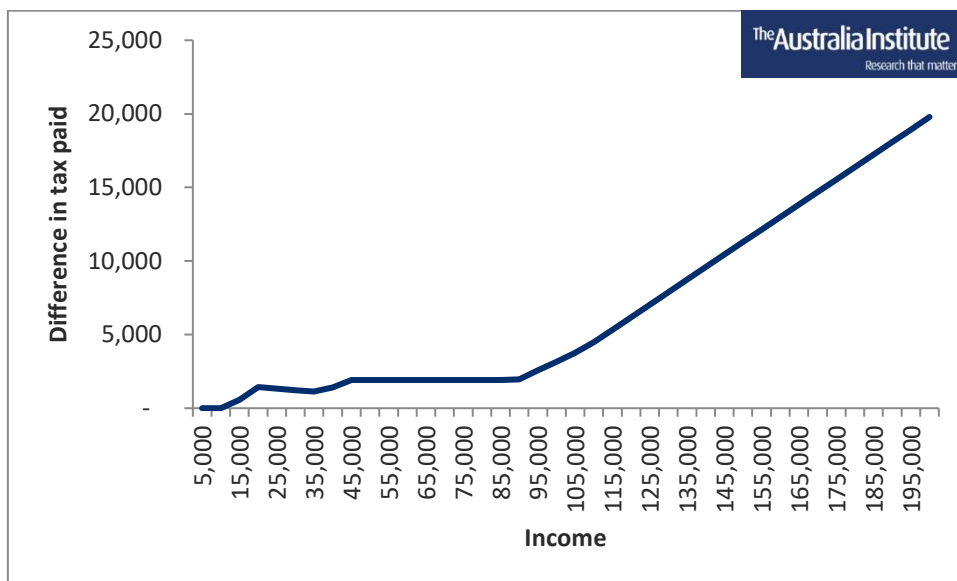
Table 1 – Comparison of bracket creep baseline with Government’s proposed tax rates in 2024-25

	Bottom bracket	Second bracket	Third bracket	Top bracket
Thresholds under tax plan	\$18,200	\$45,000		\$200,000
Rates under tax plan	19%	30%		45%
Thresholds in bracket creep baseline	\$10,757	\$35,853	\$89,629	\$107,555
Rates in bracket creep baseline	17%	30%	42%	47%
Difference in thresholds	\$7,443	\$10,147		\$92,445
Difference in rates	-2%	0%		2%

COMPARING BRACKET CREEP AND STAGE 3

If we extend our bracket creep baseline to 2024-25, which is the first year that the Government’s stage 3 tax cuts come into effect, we can see that taxpayers have been overcompensated for bracket creep at all income levels. We can also see that higher income taxpayers have been overcompensated the most.

Figure 1 – Difference between bracket creep baseline and stage 3 tax plan in 2024-25



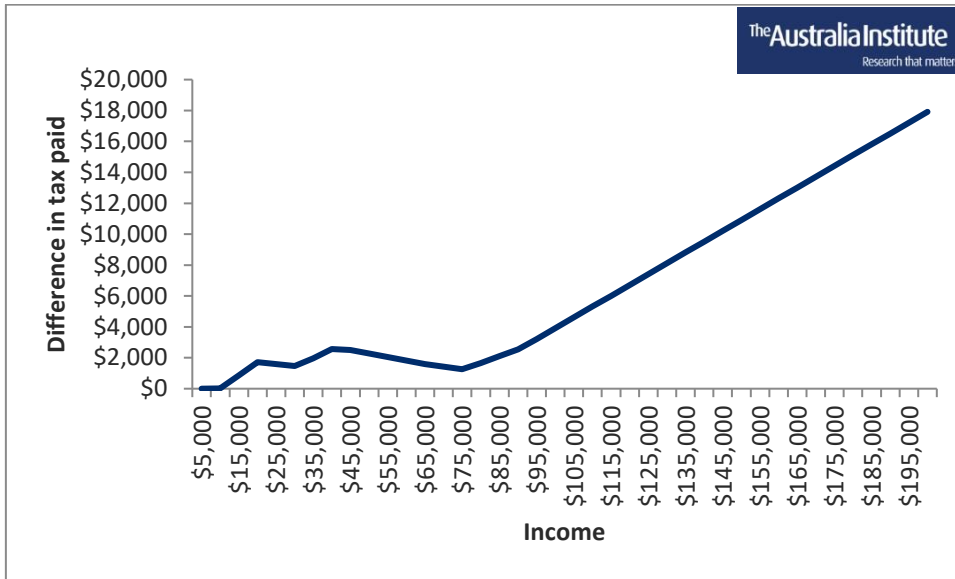
Someone earning \$60,000 a year is \$1,919 a year better off when compared to our bracket creep baseline. Someone on \$125,000 is \$7,035 better off than our bracket creep baseline. Someone on \$200,000 is \$19,785 better off than our bracket creep baseline.

Those on higher incomes are not only overcompensated by the largest amounts in dollar terms. They’re also overcompensated by a larger amount in proportion to the amount of tax they pay. Someone on \$60,000 a year’s overcompensation is 5 per cent of the total amount of income tax they have paid. Someone on \$125,000 a year’s overcompensation is 8 per cent of the total amount of tax they paid. Someone in \$200,000 a year’s overcompensation is 27 per cent of the total amount of tax they paid.

COMPARING BRACKET CREEP BASELINE WITH NO TAX CUTS

Without the government’s proposed income tax cut all income levels will still be overcompensated for bracket creep in 2024-25. That is previous tax cuts and the already legislated tax cuts are already sufficient to more than compensate all income levels for the effects of bracket creep. The difference between the bracket creep baseline and tax collected without the Government’s proposed income tax cuts are shown in Figure 2.

Figure 2 – Difference between bracket creep baseline and current taxes in 2024-25



BRACKET CREEP AND WPI

While the most appropriate measure of bracket creep is the CPI, the overcompensation for bracket creep remains for all income levels even if the bracket creep baseline uses the Wage Price Index (WPI) instead of the CPI. The difference between the bracket creep baseline adjusted for the WPI and the Government’s tax plan in 2024-25 is shown in Figure 3

Figure 3 - Difference between bracket creep baseline (WPI) and stage 3 tax plan in 2024-25

