Personal Income Tax Cuts and the new Child Care Subsidy: Do They Address High Effective Marginal Tax Rates on Women's Work?

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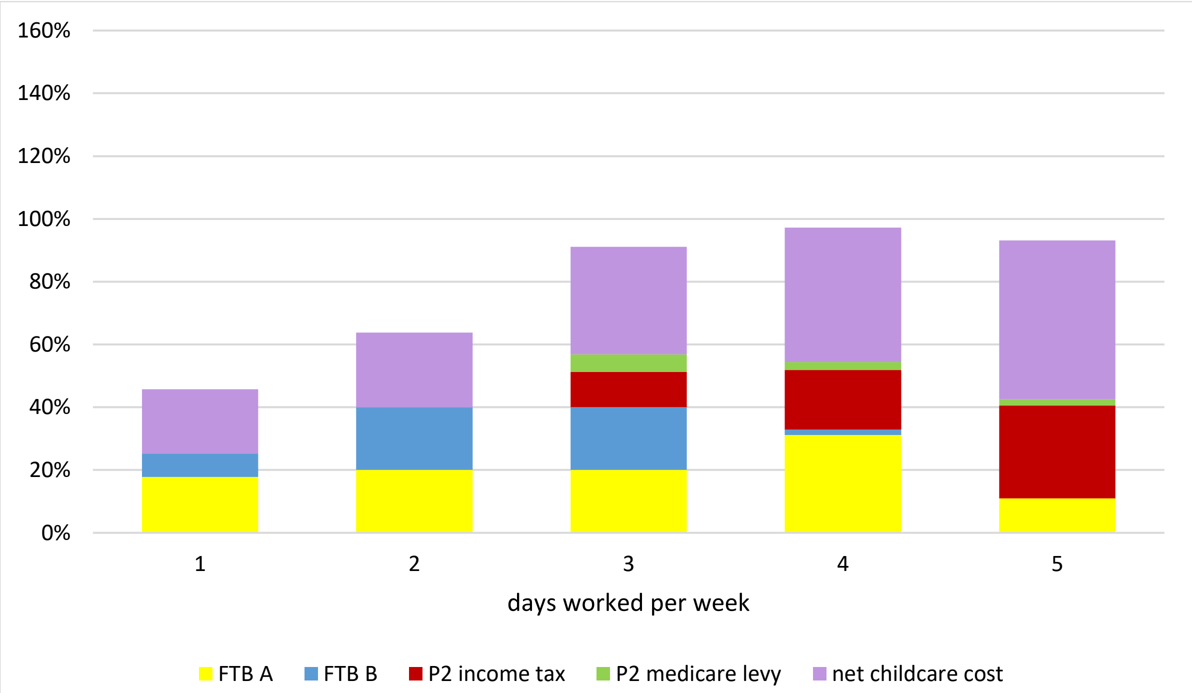
Summary

In Australia's tax and social welfare system, many women face much higher marginal tax rates on work income than the personal income tax rate structure. These **effective marginal tax rates** (EMTRs) are a consequence of the withdrawal of government benefits combined with income tax rates and the Medicare levy, as their income increases. High EMTRs apply when those caring for young children out of the workforce (mostly women) return to work or increase their work hours, and the family loses family payments and child care subsidies as they phase out on joint income.

We explore whether the Government's new Child Care Subsidy (CCS) and the announced (but not yet enacted) personal income tax cuts might alleviate this effect for women. We present charts of the EMTR per day of work, for three examples of moderate earning families. In spite of the positive effect of the CCS expansion, high EMTRs still result for increasing hours from part-time to full-time work. The personal income tax cut does not alleviate this effect. The main barrier to increasing work hours for women remains the unequal distribution of care responsibilities and the cost of child care. This is illustrated by the following cameo.

Moderate Earning Family 1. EMTR*, Second earner; Primary earner $52,730, second earner $8,976 per year per day (up to $44,880); two children age 2, 3; childcare $11.77 per hour per child (CCS; Stage 1 tax cuts) (2018)



*EMTR is measured on increment of one day's wage and incorporates net childcare cost. May also be referred to as the effective average tax rate on the daily increment. P1 income is $52,730 per year (141% of minimum wage); P2 income is $8,976 per year, per day worked (120% of minimum wage). Childcare is $11.77 per hour, per child. Source: Plunkett model.

[1] With thanks and acknowledgements to Mr David Plunkett who prepared all charts. Parameters and data can be provided.

Introduction

This short paper investigates the gender effect of the Government's Bill to introduce personal income tax cuts from the 2018-19 year out to 2024-25. It explores whether stage 1 of those tax cuts, combined with the Government's new Child Care Subsidy (CCS), will alleviate high EMTRs that are disincentives to women increasing workforce participation.

The CCS replaces Child Care Benefit (CCB) and Child Care Rebate (CCR) from 2 July 2018. The expansion of the subsidy has been estimated to cost about $3 billion over 4 years from the 2017-18 budget that introduced the changes. It raises the amount of subsidy per child up to a cap and changes the design of the taper, or phase out of CCS. The phase out is still based on joint family income.

Table 1: CCS[2]

Combined family income	Subsidy % of the actual fee charged (up to relevant percentage of the hourly rate cap)
Up to $66,958^	85 %
More than $66,958^ to below $171,958^	Decreasing to 50 %*
$171,958^ to below $251,248^	50 %
$251,248^ to below $341,248^	Decreasing to 20 %*
$341,248^ to below $351,248^	20 %
$351,248^ or more	0 %

*Subsidy gradually decreases by 1 % for each $3000 of family income.

The personal income tax cuts are proposed to apply in three stages. In Stage 1 commencing on 1 July 2018, the Bill applies the following components:

- Low and Middle Income Tax Offset (LMITO) of up to $530 for individuals with taxable income up to $125,333 for the 2018-19, 2019-20, 2020-21 and 2021-22 financial years.
- Increase the upper threshold for the 32.5 % marginal tax rate (where the 37 % rate commences) from $87,000 to $90,000.

In Stage 2 commencing on 1 July 2022 the Bill applies the following components:

- Increase the upper threshold for the 32.5 % marginal tax rate (where the 37 % marginal rate commences) from $90,000 to $120,000.
- Increase the upper threshold for the 19 % marginal tax rate (where the 32.5 % rate commences) from $37,000 to $41,000.
- Repeal the LMITO and Increase the Low Income Tax Offset to up to $645 for taxable incomes up to $66,667.

In Stage 3, commencing on 1 July 2024, the Bill applies the following components:

- Increase the lower threshold for the 45 % marginal tax rate from $180,001 to $200,001.
- Remove the 37 % marginal tax rate, so that all income from $41,001 to $200,000 is taxed at a marginal rate of 32.5 %.

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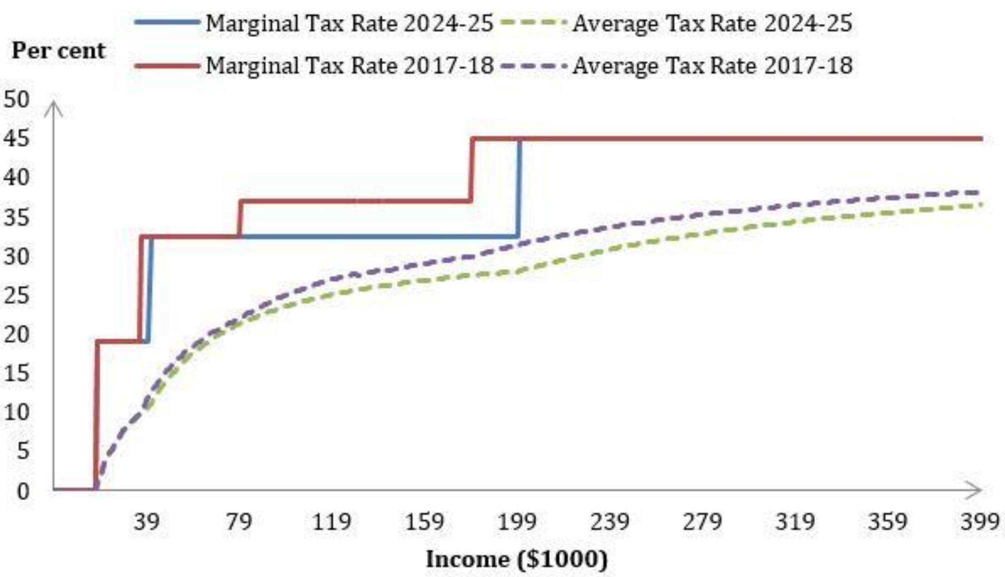
[2] https://www.education.gov.au/child-care-subsidy-combined-family-income-0

The final tax rate structure applicable from 1 July 2024 is shown in Figure 1 (excluding the Medicare Levy), compared to the current tax rate structure.

Figure 1: Tax rate structure compared (Stage 3 and current settings)



Source: TTPI Stocktake Report (2015), Figure 1.1, updated

Gender inequality and the tax cuts

Distributional analysis of the tax cuts by the Parliamentary Budget Office (PBO) demonstrates that overall, the tax cuts will benefit men significantly more than women, in each Stage, over 4 years and over 10 years.[3] This is unsurprising. ATO individual tax records data reveals very significant gender inequality in income, especially at the top of the income distribution (Table 2).

Table 2: Share at the Top of the Income distribution (2013-14), male and female

	Annual income	Men	Women
Top 10%	$94,236	74.3%	25.7%
Top 1%	$237,341	79.7%	20.3%
Top 0.1%	$698,108	82.8%	17.2%

Source: ATO individual tax records data; Stewart, Voitchovsky, Wilkins (2017)[4]. Excludes capital gains and franking credits

The tax cuts benefit men, as higher income earners (who pay more tax) the most. The unequal gender effect is, of course, not a conspiracy (as the Treasurer observed). That does not make the effect less real. Men have higher incomes than women because of substantive inequalities between men and

[3] https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Budget_Office/Publications/subs

[4] http://press-files.anu.edu.au/downloads/press/n3959/pdf/ch09.pdf

women in workforce participation, wage discrimination and because the majority of unpaid care responsibilities are assumed by women.[5]

The fiscal cost by gender of Stage 1 of the tax cuts is estimated by the PBO over 4 years at $7.28 billion for men and $6.12 billion for women. Men and women benefit close to equally from the LMITO. However, men benefit twice as much as women from the increase to the threshold for the 37% marginal tax rate from $87,000 to $90,000. More than two thirds of women earn below that threshold.

Table 3: Stage 1 Tax Cuts 4 year and 10 year estimate: male, female and total fiscal cost

	2018-19 to 2021-22 (4 years)	2018-19 to 2028–29 (10 year costing)
LMITO of up to $530 for individuals with taxable income up to $125,333		
Males	-6,050	-8,200
Females	-5,600	-7,700
Total	-11,650	-15,900
Increase the upper threshold for the 32.5 % marginal tax rate from $87,000 to $90,000		
Males	-1,230	-4,330
Females	-520	-2,120
Total	-1,750	-6,450
Total revenue – Components commencing from 1 July 2018		
Males	-7,280	-12,530
Females	-6,120	-9,820
Total	-13,400	-22,350

Source: Extracted from Table A1, PBO[6]

Effective marginal tax rates and workforce participation

In Australia's tax and social welfare system, many women face much higher marginal tax rates on work income than the personal income tax rate structure. These EMTRs are a consequence of the withdrawal of government benefits combined with income tax rates and the Medicare levy, as their income increases. High EMTRs apply when those caring for young children out of the workforce (mostly women) return to work or increase their work hours, and the family loses family payments and child care subsidies as they phase out on joint income.

The empirical evidence strongly suggests that high EMTRs deter women from increasing work hours while caring for younger children, and in the years following. Female workforce participation is increasing, but working age women still participate a full 10 percentage points less than men in the paid workforce. The proportion of women employed part-time is 46% while for men this proportion is only 17%. The gender disparity for those caring for children is most stark: the proportion of women caring for a child under 5, working part time is 62%, while for men this proportion is 8%.

[5] http://reports.weforum.org/global-gender-gap-report-2016/economies/#economy=AUS

[6] https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Budget_Office/Publications/subs

The empirical evidence also indicates that female work decisions are more **elastic** than male decisions. A woman who is caring for one or more young children in a couple is more likely than not to be the 'second earner' in the couple[7]. This means that her workforce decision is the marginal decision in the household. The 'primary earner', almost always the father, will continue working full-time.

EMTRs applying the new Child Care Subsidy and Tax Cuts from 1 July 2018

We present cameos that demonstrate the EMTRs produced by combining the new CCS[8] which replaces CCB and CCR from 2 July 2018, with Stage 1 of the income tax cuts that are intended to commence from 1 July 2018 (although not yet legislated). The charts calculate the EMTR "per day" of work for the second earner. This is calculated as the average effective marginal tax rate for each day of income earned, increasing from one day to five days (FTE).

We model the long day childcare cap at $11.77, or $117.70 for a 10 hour day. Some may be able to access childcare at a cheaper rate than this. However, many childcare centres are more expensive and cost $130 or more per day. We assume work/activation requirements are satisfied.

We model two different couple households with children. Family 1 has a relatively low wage for the primary earner of $52,730, and the second earner at $44880. Family 2 has a primary earner at $87,000 (about the average FTE male wage) and second earner at $70,000.

We also model a sole parent household at the two second earner wage levels. None of these families can be considered high income; none of them have an earner in the top 10% of the distribution. The income of the individuals in these families is closer to the median income for men and women.

We assume that Stage 1 of the tax cuts to commence in 2018 are enacted including the LMITO and raising the 37% threshold from $87,000 to $90,000. However, our modelled families will not benefit from the threshold increase, as they do not earn high enough wages. The families benefit from the LMITO, but the phase out of LMITO at 1.5% affects the EMTR over some income ranges.

We have previously modelled the effect for each day of work for an example of a second earner in a low income couple, combined with the Child Care Benefit CCB and Child Care Rebate CCR. We assumed a rather low hourly fee of $8.31 per hour for childcare and 2016 tax rate, family tax benefit and childcare settings. We found that the EMTR by day on the second earner reached 95% on Day 4 of work, as shown below. The Appendix contains that previous chart and updates previous modelling to apply the above wages and the higher childcare fee of $11.77 for comparison with CCS and 2018 tax settings.

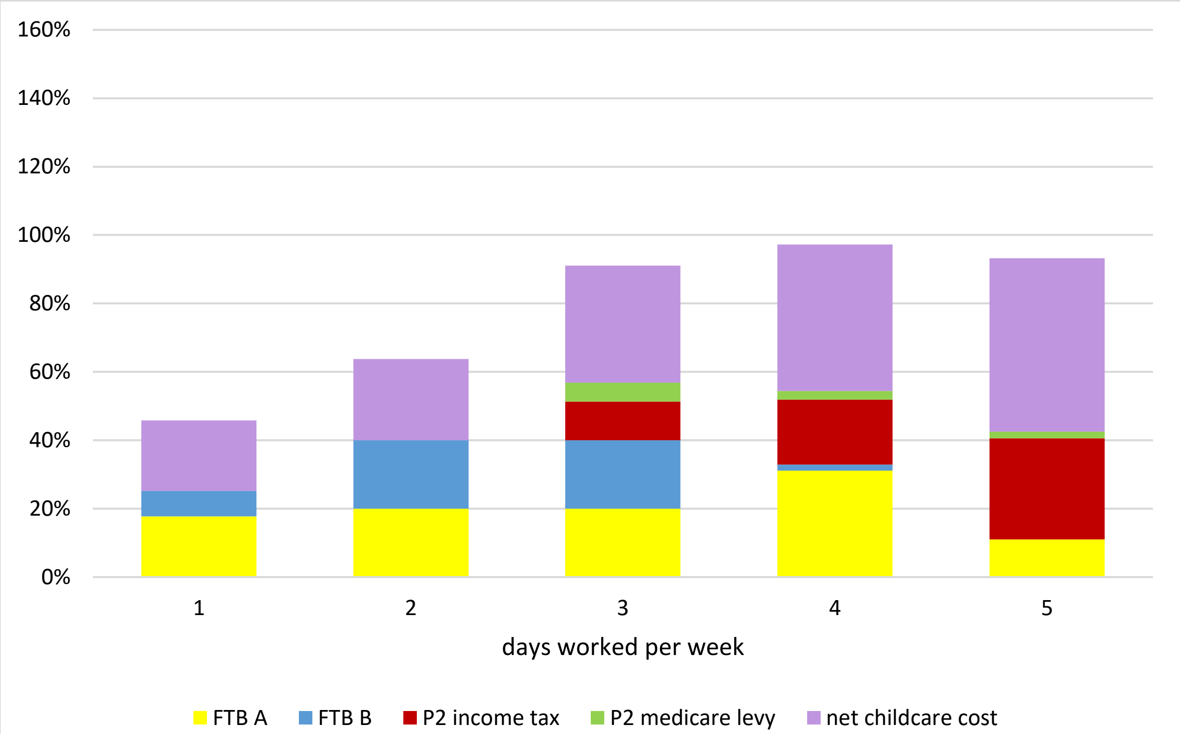
[7] That is, she may have a lower wage and/or a more flexible job than the primary earner.

[8] Fact sheet is here: https://docs.education.gov.au/node/38911

Low to moderate earning family

Figure 2 shows that the second earner in Family 1 faces a high EMTR on Days 3 to 5 of between 85% and 95%, or an average tax rate on these three days of work of about 85%. The EMTR for Days 1 and 2 of work by the second earner is more moderate although it may be noted that this is an average tax rate of about 50% over two days work.

Figure 2: Family 1. EMTR*, Second earner; Primary earner $52,730, second earner $8,976 per year per day (up to $44,880); two children age 2, 3; childcare $11.77 per hour per child (CCS; Stage 1 tax cuts) (2018)



*EMTR is measured on increment of one day's wage and incorporates net childcare cost. May also be referred to as the effective average tax rate on the daily increment. P1 income is $52,730 per year (141% of minimum wage); P2 income is $8,976 per year, per day worked (120% of minimum wage). Childcare is $11.77 per hour, per child. Source: Plunkett model.

In dollars, this means that of the second earner's salary of $8,976 per day per year, on each of Days 3 to 5, the family only retains up to about $1,300. In total, the family is better off by about $4,000 during the year, as a result of the second earner working full-time instead of 2 days per week. There remains a substantial disincentive for the second earner to work more than two days a week at this wage.

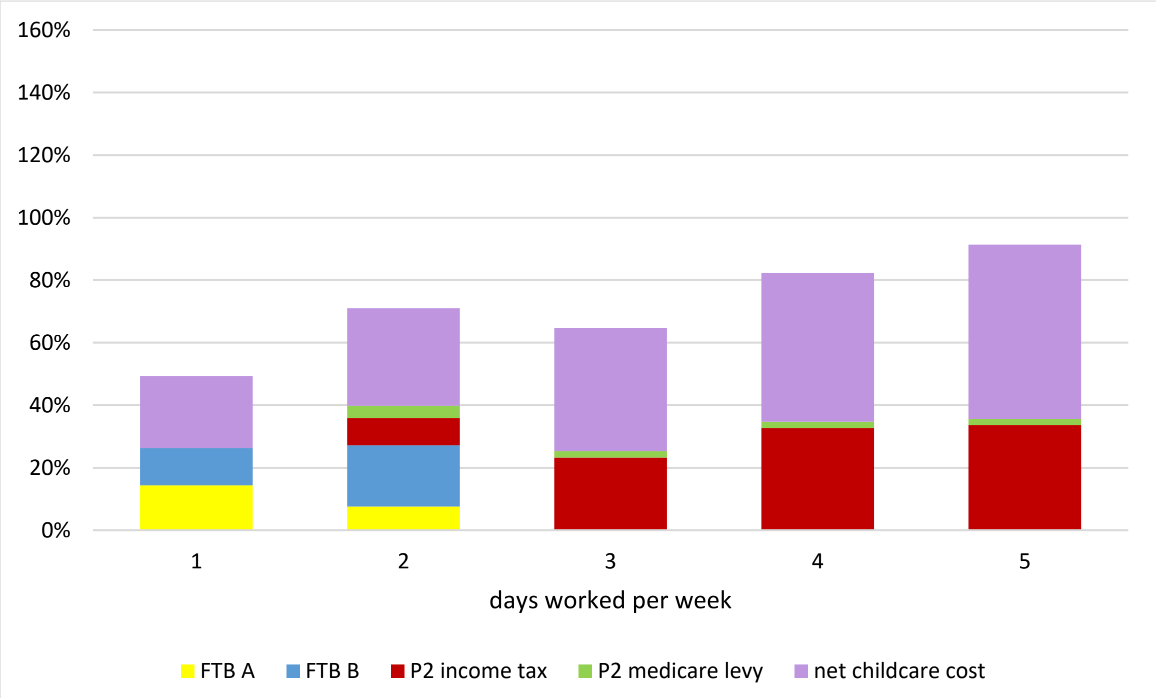
In spite of the continuing high EMTRs, the CCS has improved matters for this family. In the Appendix, Figure A2 for comparison, we set out the same scenario, applying 2016 parameters and the childcare fee of $11.77 per hour. The EMTRs under the previous regime are worse than in Figure 2, and much worse than previously modelled (at $8.31 per hour), substantially exceeding 100% on Days 3 to 5 of work (a significant net cost to the family of the second earner working on those days).

Average earning family

Family 2 earns higher incomes. In this family, the primary earner earns $87,000 per year and the second earner $14,000 per day, increasing to $70,000 per year full time. Figure 3 shows that the EMTRs for working from one to three days a week range from 45% to 65% for the second earner. The EMTRs for Days 4 and 5 of work are lower than for Family 1, but still high at just over 80%.

Therefore, in spite of the higher wages of both primary and second earner in this family, there remains only limited financial benefit for the second earner working full time, primarily as a result of the withdrawal of CCS on joint income.

Figure 3: Family 2. EMTR*, Second earner; Primary earner $87,000, second earner $14,000 per year per day (up to $70,000); two children age 2, 3; childcare $11.77 per hour per child (CCS; Stage 1 tax cuts) (2018)

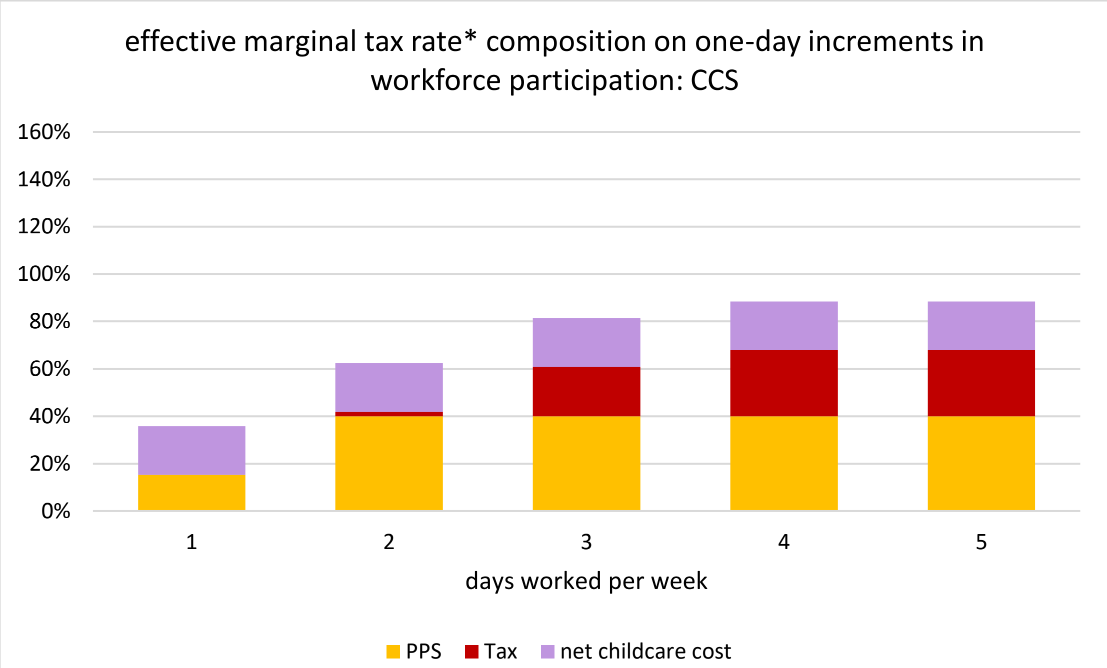


*EMTR is measured on increment of one day's wage and incorporates net childcare cost. May also be referred to as as the effective average tax rate on the daily increment. P1 income is $87,000 per year; P2 income is $14,000 per year, per day worked. Childcare is $11.77 per hour, per child. Source: Plunkett model.

What about sole parents?

We also model these settings (at the second earner wage) for a sole parent. Figure 4 shows that a sole parent on a relatively low wage faces an EMTRs of about 85% on Days 4 and 5 of work. Overall, it pays to work for sole parents, although at this wage, the benefit from moving from part time to full time work is not large. Some sole parents will benefit from a higher CCS which covers 95% of the childcare fee, or even more if they satisfy more stringent work or study requirements. We do not address that special case in our cameo.

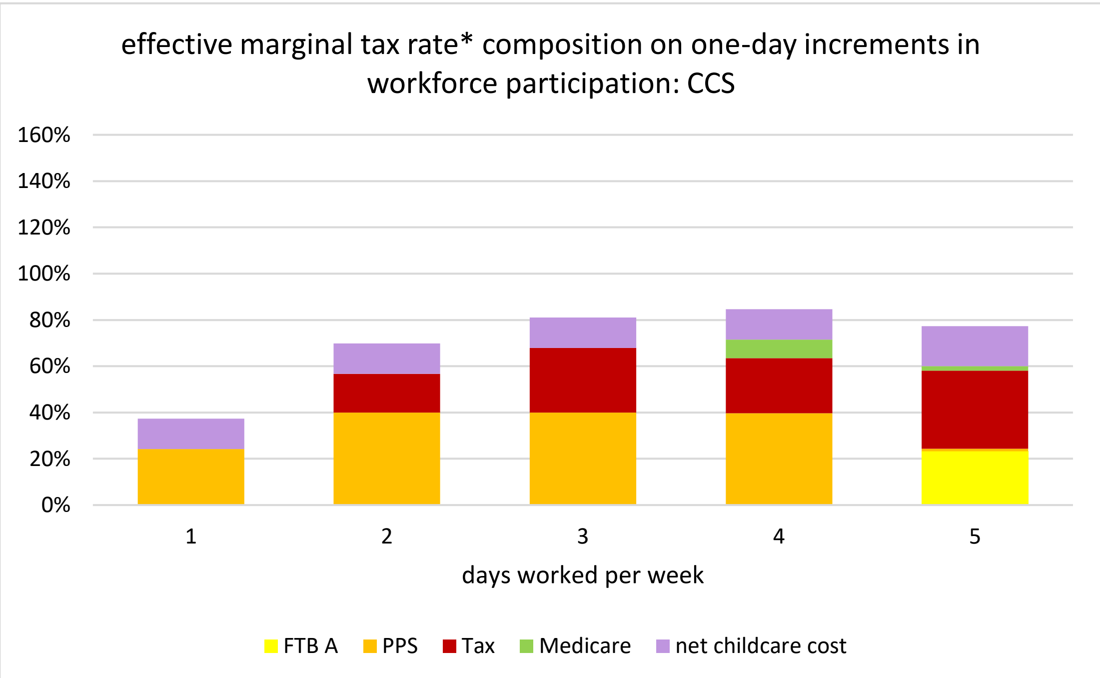
Figure 4: EMTR*, Sole parent; $8,976 per year per day (up to $44,880); two children age 2, 3; childcare $11.77 per hour per child (CCS; Stage 1 tax cuts) (2018)



*EMTR is measured on increment of one day's wage and incorporates net childcare cost. May also be referred to as the effective average tax rate on the daily increment. Income is $8,976 per year, per day worked. Full time is $44,880 (approx 120% of minimum wage. Childcare is $11.77 per hour, per child. Source: Plunkett model.

Figure 5 shows that a sole parent earning a higher wage is in a better position by being in full time work; however, the EMTR reaches 80% on Days 3 to 5 of work.

Figure 5: EMTR*, Sole parent; $14,000 per year per day (up to $70,000); two children age 2, 3; childcare $11.77 per hour per child (CCS; Stage 1 tax cuts) (2018)



*where EMTR is measured on increment of one day's wage and incorporates net childcare cost. May also be referred to as the effective average tax rate on the daily increment. Income is $14,000 per year, per day worked. Full time is $70,000. Childcare is $11.77 per hour, per child. Source: Plunkett model.

Still a long way to go to remove high EMTRs on women's work

Women's workforce participation rates have increased markedly since the 1970s, but this increase has been concentrated almost entirely in part-time work. The greatest dip in female workforce participation occurs when a household is caring for one or more children under the age of five. There are cultural and social reasons for this, but there are also economic reasons: it is a rational response to high EMTRs applicable to workers with elastic labour supply.

The new CCS improves EMTRs for second earners in our cameos compared to CCB and CCR. However, only a small benefit is provided by the Stage 1 LMITO and the personal tax cuts make little impact on these high EMTRs. Even in the new regime, second earners, mostly women, as well as sole parents, still face high EMTRs on moving from part-time to full time work. In many cases, the family is better off by only a relatively small amount by the mother moving to full time work.

The daily EMTRs second earners face are significantly higher than the marginal rates faced by higher earning full time workers – including those at the threshold of $90,000 which is enacted for the 37% tax rate. The main cause of the high EMTRs is the income-tested withdrawal of family tax benefit and CCS based on joint family income. The second earner's salary is piled "on top" of the primary earner's income, leading to the phase out of these benefits at about the level of income when the second earner would increase her days worked from part time to full time.

Families avoid the effect of these EMTRs in several ways. Women, and/or couples jointly, decide that it is not financially worthwhile to work full-time. In most families, it is still the mother who reduces her work hours to do unpaid care in the home. As many as 30% of families access grandparental or other informal care at least one day a week.[9] If the childcare cost can be eliminated for a day, then the choice to increase paid work hours looks significantly more attractive. But many families do not have access to informal care for various reasons; nor is it always a sustainable option for families.

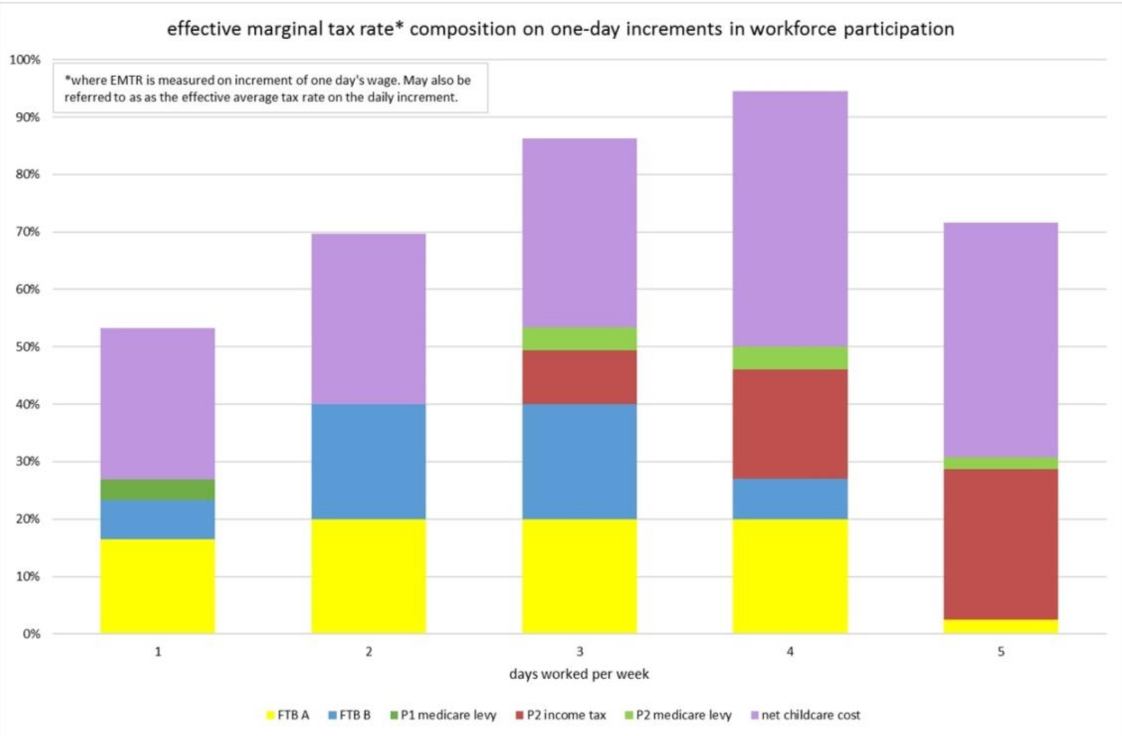
Some families obtain cheaper care. Family day care, and some childcare centres, have lower fees than the cap of $11.77 that we model. A lower cost of care net of the subsidy will produce lower EMTRs. However, cheaper care is not always available and child care wages are already relatively low. The quality of care is important to Australian families and many invest in more expensive care than the government cap.

One of the most pressing economic growth agendas we face is increasing women's paid work hours. This would pay dividends for household income, consumption, saving, productivity, women's economic security and independence – and taxes. At a fiscal cost over four years for Stage 1 only of $13.4 billion, the personal income tax cuts dwarf the fiscal cost of about $3 billion of expanding childcare support, but do not remove the disincentives to do paid work of many women. Stages 2 and 3 of the tax cuts are at a much higher fiscal cost; again, they benefit men much more than women. The tax cuts have the direct consequence that money is not available to fund public goods and services now and into the future, in particular, child care, that would benefit women and men more equally while also achieving economic goals.

[9] https://aifs.gov.au/publications/child-care-and-early-childhood-education-australia

APPENDIX (2016 settings, updated)

Figure A1: Family 1, 2016 settings. EMTR second earner, $50,000, primary earner $50,000, two children aged 2, 3; childcare at $8.31 per hour



Source: Stewart (2017), Figure 1.8b.

Figure A2: Family 1 (2016 settings, updated). EMTR*, Second earner; Primary earner $52,730, second earner $8,976 per year per day (up to $44,880); two children age 2, 3; childcare $11.77 per hour per child (CCB, CCR)

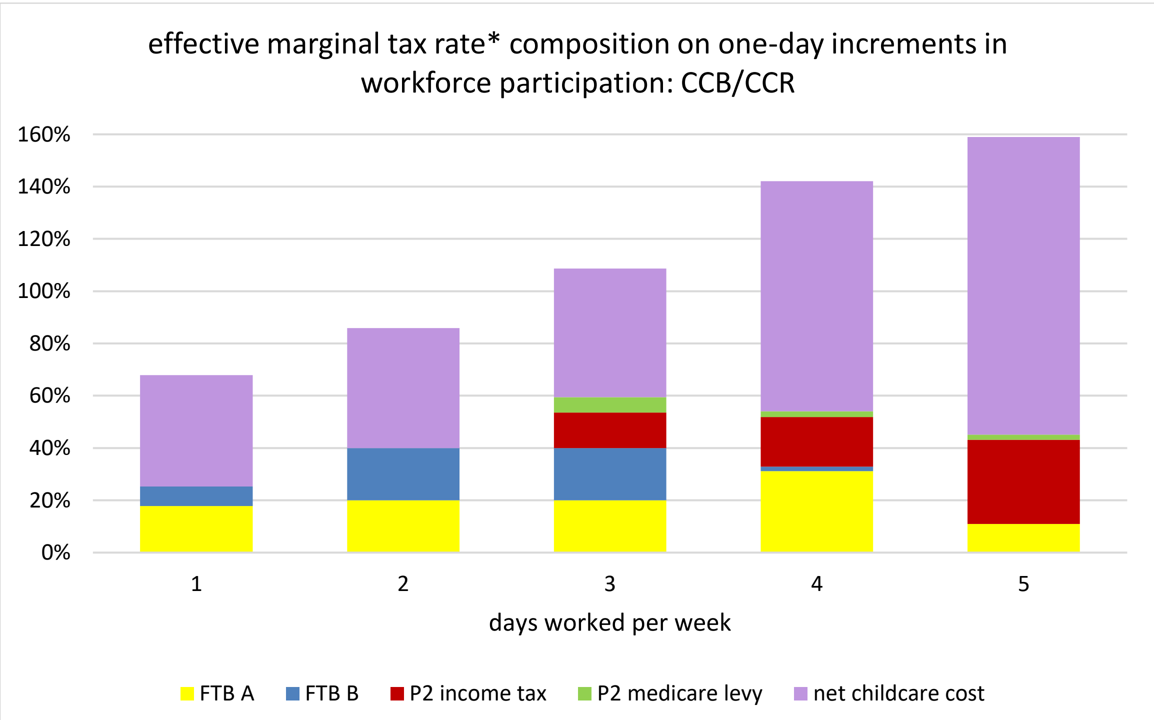


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Figure A3: Family 2. (2016 settings, updated)