The impact of removing the tax-free threshold from Working Holiday Makers

A Lateral Economics report for the Australian Chamber of Commerce and Industry

21 October 2016

LateralEconomics

CAPABLE, INNOVATIVE, RIGOROUS

1 Introduction and summary

As part of its Working Holiday Maker Reform Package, the Commonwealth Government is proposing a series of measures including:

- a removal of the tax-free threshold available to Working Holiday Makers (WHMs) who are resident for tax-purposes, and
- an increase in the passenger movement charge (PMC).

The Australian Chamber of Commerce and Industry (ACCI) is concerned that the Government has underestimated the amount of revenue that will be raised from the proposed tax changes on WHMs and therefore that the proposed increase in the PMC is unnecessary.

To gain clarity, the ACCI commissioned Lateral Economics to prepare this paper to estimate the projected impact of the change in Government revenue of the proposed change to remove the tax-free threshold.

A summary of our results is included in the table below. Our best estimate is that the revenue raised by the WHM tax change to remove the tax-free threshold is in the order of $232 million per annum.

Additional sensitivity analysis is included in the body of the report.

Table 1: Summary results

Impact of revenue	Implied from financial estimates	Our estimate	Difference
19% tax rate on WHMs	$120m	$232m	$112m

2 Background

Currently, WHMs who are residents for tax purposes are able to make use of the tax-free threshold (which in 2015–16 is up to $18,200).[1] Those who are non-resident are taxed at 32.5 cents in the dollar; however, we understand that most WHMs claim residency for tax-purposes.

The 2015 Budget included a proposal that all WHMs be treated as non-residents for tax purposes and subject to the 32.5 cents rate. At the time, the Government estimated that in a full year (2017-18), this measure would raise $220 million.

The measure was not introduced. More recently, the Government announced a Working Holiday Maker Reform Package[2] that included:

- A 19 per cent tax on earnings up to $37,000 (in effect, a removal of the tax-free threshold), rather than the 32.5 per cent announced in the 2015-2016 Budget.
- An increase in the tax on Departing Australian Superannuation Payments (DASP) to 95 per cent (from 38 per cent).
- Other measures to encourage WHMs include:
    - Support of a Tourism Australia advertising campaign
    - Reform to provide greater flexibility for employers of WHMs; and
- A requirement for the WHM employer to register the WHM with the ATO.
- An increase in the passenger movement charge (PMC)[3] from $55 to $60 as of 1 January 2017.

Accompanying the announcement of the proposal was a revised estimate of the additional net revenue from the combined measures (provided in the table below).

This suggested that the Government will receive $100 million per annum less from the lower tax rate on WHMs' taxable income (19 per cent rather than the 32.5 per cent that was proposed originally). This, coupled with the previous estimates, suggests that the measure will

---

1 https://www.ato.gov.au/Individuals/Working/In-detail/TFN-declaration/what-is-the-tax-free-threshold/

2 http://sjm.ministers.treasury.gov.au/media-release/104-2016/

3 The PMC is a charge tax payable by all persons departing Australia for another country, whether or not the passenger intends to return to Australia.

raise $120 million per annum. Also, as shown in the table, the Government projects it will receive up to $105 million per annum from the increase in the PMC.

Table 2: Working holiday maker reform package – financial impact

	2016-17	2017-18	2018-19	2019-20	Total FE
1. Lower tax rate for all working holiday makers (WHMs)	-25.0	-75.0	-100.0	-100.0	-300.0
2. Reduce WHM visa application charge by $50	0.0	-10.0	-10.0	-10.0	-30.0
3. Tourism Australia advertising campaign	-2.5	-5.0	-2.5	-0.0	-10.0
4. Providing greater flexibility for employers of WHMs	0.0	0.0	0.0	0.0	0.0
5. Compliance for WHM employer register	-3.5	-3.5	-1.5	-1.5	-10.0
6. Increase passenger movement charge by $5 (no indexation)	0.0	55.0	100.0	105.0	260.0
7. Increase tax on the Departing Australia Superannuation Payment to 95 per cent	0.0	35.0	35.0	35.0	105.0
Total	***-31.0***	***-3.5***	***21.0***	***28.5***	***15.0***

3 The impact

Broadly, the revenue raised from the 19 per cent tax rate on WHMs can be simply estimated as:

- The taxable income of WHMs who are resident for tax purposes that is below the threshold tax level
- Multiplied by 19 per cent
- Adjusted for changes that occur in response to the policy.

3.1 The taxable income earned by WHMs

We are unaware of any current estimates of the total taxable income earned by tax-resident WHMs. However, the amount may be reasonably assessed from estimates of

- The number of WHMs,
- The proportion that are working and are residents for tax status, and
- The average taxable income below the tax-free threshold of those working.

3.1.1.1 Number of WHMs

The number of WHMs is provided by the Department of Immigration and Border Protection (see table below).[4]

Table 3: Total number of working holiday visas

	2011-12	2012-13	2013-14	2014-15	2015-16
WHMs granted	**222,992**	**258,248**	**239,592**	**226,812**	**214,583**
percentage change from prior year		16%	-7%	-5%	-5%

In 2015-16, 214,583 WHM applications were granted. As reflected in the table, the number of WHMs has been in decline since a peak in 2012-13. The Government has attributed the decline to 'factors including exchange rate variations and changed economic conditions in source countries'.[5]

---

4 Available at https://www.border.gov.au/ReportsandPublications/Documents/statistics/working-holiday-report-jun16.pdf

5 http://sjm.ministers.treasury.gov.au/media-release/104-2016/

We would expect that the introduction of the 19 per cent tax would, in isolation, cause some further reduction in the number of WHMs. However, there are other factors to consider, including the following:

- The fall in WHMs in 2015-16 may in part be in response to the 2015 budget measures (announced in May 2015) of the 32.5 per cent tax. To this extent, the revised reform may be perceived as improvement for WHMs.
- The Government has announced other measures to encourage WHMs, including increased expenditure on promotion and an increase in the age limit to 35.
- In response to a reduction in the supply of WHM applicants, there would be some demand response whereby WHM employers attempt to offset the negative impact of the tax.
- Finally, while Australia competes with other nations in attracting holiday workers, we expect that the unique characteristics of Australia mean that the demand response would be reasonably limited.

Given the factors above, we have assumed that the WHMs in the future will be around 200,000 per annum.

Taxable income per WHM

There are a number of sources of information on the income earned by WHMs. These include:

- The 2009 study estimated that the average earnings of WHMs working in 2007/08 was $10,677.
- A submission from "Taxback.com",[6] (a commercial tax company specialising in working holiday makers) to the recent Government review indicated that its 16,099 clients earned an average gross income of just over $14,216.
- A 2002 Melbourne Institute study for the Department of Immigration provided a figure of $9,916 per WHM.[7]

Allowing for wage inflation (which we have conservatively assumed to be at the rate of growth of the minimum wage),[8] the average earnings

---

6 http://www.agriculture.gov.au/SiteCollectionDocuments/ag-food/working-holiday/submissions/taxback.com.pdf

7 https://melbourneinstitute.com/downloads/industrial/Reports/Working%20Holiday%20Makers%202002.pdf

in 2016/17 suggested by the two most recent studies (the 2009 study and the Taxback data) are between $14,000 and $15,000. We have assumed $14,500 as our best estimate.

The average taxable income currently under the tax-free threshold will be less than this amount for two reasons.

First, the taxable income needs to be reduced by the superannuation guarantee payments of 9.5 per cent.

Second, the average income estimates provided above will include some income that is earned above the tax-free threshold. As the policy change does not affect the rate of tax on the amount earned above the tax-free threshold, an adjustment is required.

The Taxback.com submission reports some evidence of this. The submission reports an average tax contribution of $786 on an average income of $14,212.[9] Using this amount to estimate the applicable tax rate, we can estimate the income earned above the tax-free threshold.[10] For example, if the average rate of tax paid on income earned above the tax-free threshold was 25 per cent, then this would imply 22 per cent of the average income of $14,212 was above the tax-free threshold and therefore not subject to the new 19 per cent tax. We have conservatively assumed that the tax rate applied is only 19 per cent,[11] which implies that 29 per cent of the average taxable income was above the tax-free threshold.

Combining the above information, our estimate of the average taxable income that is under the tax-free threshold of WHMs who are resident for tax purposes is around $9,300.

3.1.1.2 The number of WHMs working

Not all WHMs use their visa to work in Australia. A report in the 2009 “Evaluation of Australia’s Working Holiday Maker Program” (hereafter the 2009 Evaluation)[12] reported the results of a 2008 survey of WHMs

---

8 We expect the wage inflation for WHMs to be at least that of the growth in the minimum wage. We expect an upper limit to be the growth in average weekly earnings.

9 This seems surprisingly high and it may reflect the Taxback.com sample.

10 The average earnings under the tax-free threshold are estimates as taxable earnings less tax contribution/average tax rate on income above tax-free threshold.

11 In 2014/15 including the Medicare Levy and Budget Repair Levy, marginal tax rates above the threshold ranged from 19 per cent to 49 per cent.

12 Yan Tan, Sue Richardson, Laurence Lester, Tracy Bai, and Lulu Sun. "Evaluation of Australia's Working Holiday Maker (WHM) Program." (2009) by the National Institute of Labour Studies at Flinders University.

who had recently departed Australia. Based on the survey results, 69.1 per cent of WHMs worked.

We have received some anecdotal evidence that the current ratio may be significantly higher than 69.1 per cent and that most WHMs earn some income. It seems reasonable that the proportion of WHMs who work will have grown over time as result of improved information about job opportunities. Nevertheless, we have no evidence that can be presented to improve on the 2009 survey result. Furthermore, we have no reason to expect that the proportion of working WHMs will change with the proposed changes. Given the above, we have used the assumption that 69.1 per cent of WHMs will work, but we expect this estimate may be conservatively low.

3.2 Residency status

The change in the tax-free threshold only has an impact on WHMs who are resident for tax purposes. Non-residents for tax purposes continue to be charged at a 32.5 per cent tax rate.

With some limited exceptions, WHMs must be in Australia for more than 183 days in the income year to be ruled as resident for tax purposes.[13] Regardless, we understand that compliance with this requirement may be an issue,[14] and that most WHMs self-assess as resident for tax purposes.

To estimate the proportion of non-resident WHMs earning an income, we examined the tax records.

According to the 2013-14 tax statistics, there were around 11,500 tax-returns submitted by non-resident workers in Australia aged between 18 and 30. That was less than 5 per cent of the WHM visas issued in 2014.[15] Furthermore, the amount includes those on other visas (i.e. not on WHMs).[16]

A related consideration is that WHMs who are in the country for fewer than 183 days may not lodge a tax return due to the concern that they will be assessed as non-resident. We understand that in such cases, the WHMs would likely have paid some tax via PAYG deductions from

---

13 https://atotaxrates.info/non-residents/

14 See for example, the submission by Taxback.

15 In addition, there may be some non-resident workers that failed to submit a tax return. However, we expect this to be most likely the case when earnings were small and therefore, to not be a significant factor in calculating any adjustment to taxable income.

16 This may be significant. There were in excess of 80,000 tax returns submitted by non-residents in other age groups (not applicable to WHMs).

their payslip and therefore, the additional tax-revenue collected may be less than 19 per cent. However, we expect this effect to be small.

In light of these considerations, we have discounted the estimated of that taxable income subject to the new 19 per cent tax by 5 per cent.

3.3 Adjustments for the changes to the policy

The removal of the tax-free threshold for resident WHMs may be expected to have a number of side effects.

First, there may be a change in the supply of labour. As has already been considered above, the policy may discourage some potential WHMs from applying for a visa.

The change may also have an impact on the labour supply of those WHMs who come to Australia. It may result in some WHMs working less due to the lower post-tax wage rate. This effect may be offset or even outweighed by an 'income effect' whereby WHM work more hours to compensate for the lower post-tax wages.

Second, employers may respond to lower labour supply by offering improved wages and/or conditions.

Given the above considerations, we think it reasonable to assume the combined demand and supply effects are adequately captured in the assumption regarding the reduced number of WHMs.

Finally, removal of the tax-free threshold may encourage attempts to avoid the tax by, for example, greater use of cash payments. We have no reasonable basis to estimate the significance of these impacts.

3.4 Summary results

The results of our analysis are summarised below

Table 4: Summary results

Key assumptions	
Number of WHMs	200,000
Per cent of WHMs who work	69.1 per cent
Per cent of working WHMs who do not claim residency status	5 per cent
Average gross earnings of resident working WHMs	$14,500
Average taxable income *under the tax-free threshold* by resident working WHMs	$9,300

Results	
Total income against which the 19 per cent tax would apply	$1,221 million
Additional tax collected from removing the tax-free threshold	$232 million

As noted in the text above, one can mount arguments to modify assumptions that would raise or lower the key result. However, on balance – with the caveat that we cannot reasonably estimate the impact of the tax avoidance – the above result reflects our best estimate. We believe the greatest uncertainty in these assumptions relates to the number of WHMs who work. We assume that greater clarity on this and some other assumptions could potentially be achieved with some data available to Government.

Our best estimate is that the additional revenue generated by the measure is well in excess of the implied Government estimate of $120 million.