PART 2: PERSONAL INCOME TAX REFORM

Since 2000, the Government has undertaken a range of far-reaching reforms to the tax system. These reforms have reshaped Australia's personal, business, superannuation, indirect and international tax landscape and ensured that Australia remains a low tax country compared to the standards of the developed world. The reforms to the tax system have increased incentives to work, save and invest, reduced costs and complexity, and improved Australia's international competitiveness.

The Government's objective of keeping the Budget in surplus has been maintained whilst also maintaining its commitment not to increase the overall Commonwealth tax burden from 1996-97 levels. In fact the tax burden has fallen significantly from 1996-97 levels.

Tax reform goal

The Government has now decided on an ambitious new goal to drive tax reform much further. This goal can be met if the expected strong economic and fiscal conditions continue. The goal is that in five years time (2012-13) the personal income tax system will have the following features:

- A rate scale of 15 per cent, 30 per cent, 35 per cent, and 40 per cent;
- Forty-five per cent of taxpayers[1] facing a marginal tax rate of 15 per cent or less;
- Eighty-five per cent of taxpayers facing a marginal tax rate of 30 per cent or less;
- Ninety-eight per cent of taxpayers facing a marginal tax rate of 35 per cent or less; and
- An enhanced low income tax offset (LITO) that will mean that low income earners will have an effective tax free threshold of $20,000.

Tax reform plan

The Government has decided to cut tax as part of a plan to commence on 1 July 2008. Across the forward estimates this will mean tax cuts of $34 billion.

This will result in a significant reduction in taxes for all individual taxpayers while maintaining the sustainability of the revenue base. In particular, the reforms provide added incentives for low income workers to participate in the workforce.

---

1 Defined as a resident adult who is not a full-rate pensioner or beneficiary and who has a taxable income greater than the tax free threshold of $6,000, but does not necessarily have a net tax liability.

From 1 July 2008, the 30 per cent threshold will increase from $30,001 to $34,001. In addition, from 1 July 2009, the 30 per cent threshold will be further increased to $35,001 and the 40 per cent and 45 per cent tax rates will be reduced to 38 per cent and 43 per cent. From 1 July 2010, the 30 per cent threshold will be increased again to $37,001 and the top marginal tax rates will be cut to 37 per cent and 42 per cent.

Table 3 outlines the new personal tax rates and thresholds for the forward estimates period.

Table 3: New personal tax rates and thresholds

Current		From 1 July 2008		From 1 July 2009		From 1 July 2010	
Taxable income ($)	Rate (%)	Taxable income ($)	Rate (%)	Taxable income ($)	Rate (%)	Taxable income ($)	Rate (%)
0 - 6,000	0	0 - 6,000	0	0 - 6,000	0	0 - 6,000	0
6,001 - 30,000	15	6,001 - **34,000**	15	6,001 - **35,000**	15	6,001 - **37,000**	15
30,001 - 75,000	30	**34,001** - 80,000	30	**35,001** - 80,000	30	**37,001** - 80,000	30
75,001 - 150,000	40	80,001 - 180,000	40	80,001 - 180,000	**38**	80,001 - 180,000	**37**
150,001 +	45	180,001 +	45	180,001 +	**43**	180,001 +	**42**

Low and middle income earners will be further assisted through an increase in the LITO. From 1 July 2008, the LITO will increase from $750 to $1,200. It will continue to be withdrawn from the income level of $30,000. Those eligible for the full LITO will not pay tax after assessment until their annual income exceeds at least $14,000 (up from the current level of $11,000). Further increases in the LITO, to $1,350 from 1 July 2009 and to $1,500 from 1 July 2010 will mean that the effective tax free threshold will increase further to at least $15,000 in 2009-10 and $16,000 in 2010-11, towards the goal of $20,000.

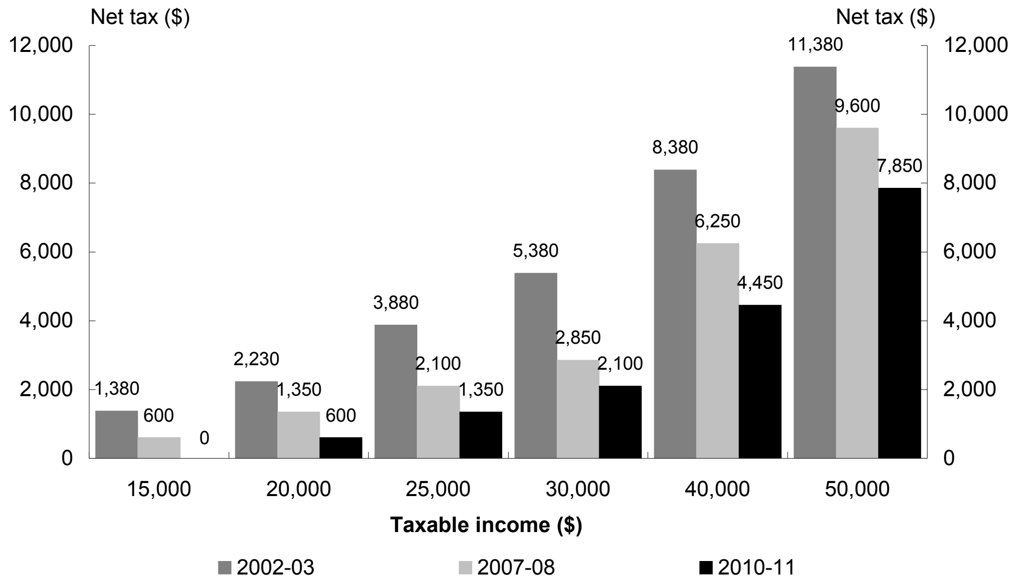
Given the large increase in the amount of the offset, new withholding schedules will be created so that low and average income earners will receive half of the benefits of the LITO through their regular pay, rather than receiving the total as a lump sum when their income tax returns are assessed. This will bolster participation incentives by allowing people to realise sooner the benefits of working more.

Senior Australians will also benefit from these changes and related increases. Senior Australians eligible for the senior Australians tax offset (SATO) and the LITO currently do not pay tax until they reach an annual income of at least $25,867 for singles and $21,680 for each member of a couple. As a result of the Government's personal income tax plan, from 1 July 2008 these income levels will be lifted to $28,867 for singles and $24,680 for each member of a couple. By 2010-11, the income levels will be $30,685 for singles and $26,680 for each member of a couple.

The fringe benefits tax rate will also be reduced in line with reductions in the top marginal tax rate (including the Medicare levy), decreasing to 44.5 per cent from 1 April 2009 and to 43.5 per cent from 1 April 2010.

These tax cuts build on the significant reductions in personal income tax for low and average income earners that have resulted from tax cuts delivered in the last five budgets. Chart 2 shows the net reductions in tax that will result over the forward estimates period.

Chart 2: Reductions in net income tax paid by low and average income earners



The 2007-08 MYEFO tax cuts build on the reforms delivered in The New Tax System introduced in 2000-01 and the 2003-04, 2004-05, 2005-06, 2006-07 and 2007-08 budgets. The overall effect has been to deliver significant reductions in tax for all Australian taxpayers.

- Adult taxpayers earning $30,000 paid $6,222 in income tax prior to The New Tax System (excluding the Medicare levy) whereas taxpayers on that income will, from 1 July 2010, pay $2,100; a reduction of 66 per cent.

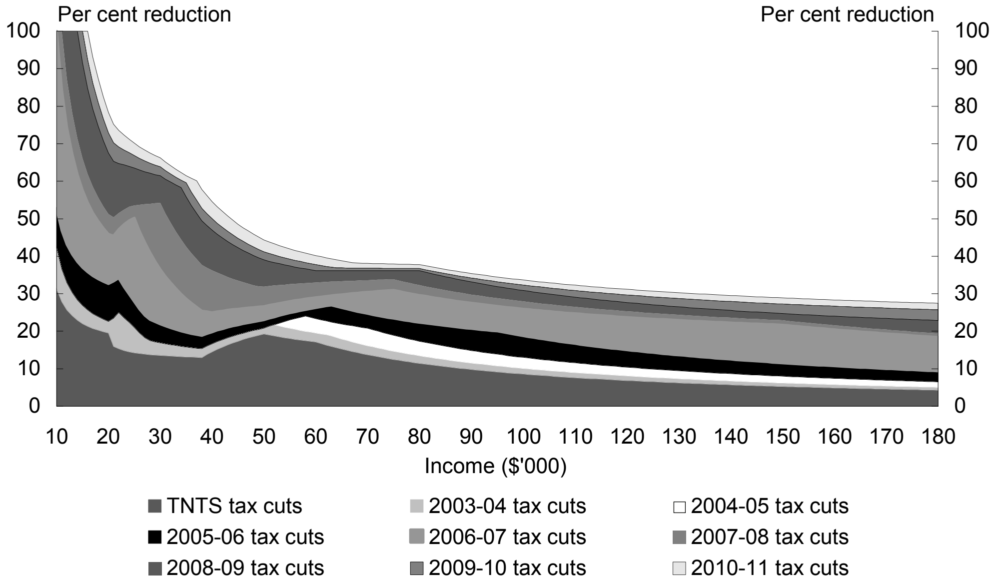
- Taxpayers on $60,000 paid $18,802 in income tax prior to The New Tax System (excluding the Medicare levy) whereas taxpayers on that income will, from 1 July 2010, pay $11,250; a reduction of 40 per cent.

- Taxpayers on $100,000 paid $37,602 in income tax prior to The New Tax System (excluding the Medicare levy) whereas taxpayers on that income will, from 1 July 2010, pay $24,950; a reduction of 34 per cent.

- Taxpayers on $180,000 paid $75,202 in income tax prior to The New Tax System (excluding the Medicare levy) whereas taxpayers on that income will, from 1 July 2010, pay $54,550; a reduction of 27 per cent.

As shown in Chart 3 below, in percentage terms, the greatest tax cuts have been provided to low and average income earners.

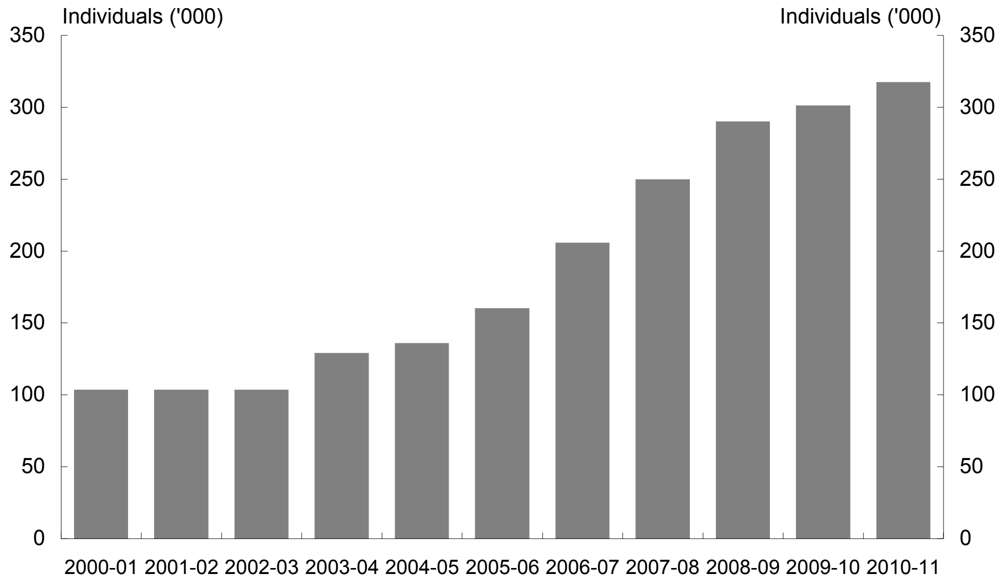
Chart 3: Personal income tax savings since The New Tax System



The Government has already made significant progress towards achieving its plan for the personal tax system. For example, the effective tax free threshold for low income earners has been increased from $6,150 prior to 1 July 2000, to $11,000 in 2007-08, and will increase further to $16,000 from 1 July 2010.

The 2007-08 MYEFO tax cuts and the Government's goal for the personal income tax system will continue the focus on encouraging workforce participation that has been a feature of the tax cuts delivered by the Government since the introduction of The New Tax System. The estimated impact of the 2007-08 MYEFO tax cuts is to encourage around 65,000 new entrants into the workforce. The cumulative effect of the tax cuts delivered by the Government since The New Tax System is estimated to encourage around 300,000 new entrants to the workforce (see Chart 4). To put this into perspective, this is roughly equivalent in size to a three percentage point fall in the unemployment rate.

Chart 4: Estimated cumulative workforce impacts from personal tax scale changes*



Source: Treasury version of the Melbourne Institute Tax and Transfer Simulator (MITTS).
*The actual workforce impacts are likely to be spread beyond the years of introduction of the tax scale changes.

These tax reforms will also assist in improving Australia's competitiveness with other OECD countries. Australia is a low tax country — the eighth lowest in the OECD. With the fall in the top marginal tax rate as part of the planned tax cuts, Australia's attractiveness to highly skilled workers from overseas will be enhanced. The average ('all in') top marginal rate for OECD countries was 46.6 per cent in 2006. The Government's plan will reduce Australia's top marginal rate to 42 per cent from 1 July 2010, with the goal of further lowering it to 40 per cent over the next two years. When the Medicare levy is included, Australia's top marginal rate will be significantly below the average for the OECD.