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Document 1

— For taxable incomes above $45,000: Increasing the top threshold of the 19 per cent tax bracket from $37,000 to $45,000 from 2022-23 delivers a benefit of $1,080 to these taxpayers, which is equal to the $1,080 maximum benefit of LMITO.

— For taxable incomes between $37,000 and $45,000: The increase to the top threshold of the 19 per cent tax bracket more than fully compensates these taxpayers for the removal of LMITO and the increased phase-out of the LITO.

Summary of changes to rates and thresholds under the plan

Table 1: Personal tax rates and thresholds

Rate (%)	2017-18 tax thresholds Income range ($)	Tax thresholds From 1 July 2018 Income range ($)	Tax thresholds From 1 July 2022 Income range ($)	Rate (%)	Tax thresholds From 1 July 2024 Income range ($)
Tax free	0 - 18,200	0 - 18,200	0 - 18,200	Tax free	0 - 18,200
19	18,201 - 37,000	18,201 - 37,000	18,201 - 45,000	19	18,201 - 45,000
32.5	37,001 - 87,000	37,001 - 90,000	45,001 - 120,000	30	45,001 - 200,000
37	87,001 - 180,000	90,001 - 180,000	120,001 - 180,000	-	-
45	>180,000	>180,000	>180,000	45	>200,000
LMITO	-	Up to 1,080 (base offset $255)	-	LMITO	-
LITO	Up to 445	Up to 445	Up to 700	LITO	Up to 700

Note: the shaded areas show the changes announced in the 2019-20 Budget.

Benefits of the tax cuts

- Lower marginal tax rates increase the financial return from work. Higher take-home pay may encourage some workers to re-enter the workforce, or seek additional hours.

- The tax cuts will also support growth in household disposable income and consumption. This will in turn support economic growth, as household consumption accounts for around 60 per cent of the economy.

Progressivity

- Even though the tax cuts result in lower *marginal* tax rates, improving incentives to work, the tax system will remain progressive because average tax rates will continue to rise with income. For example, in 2024-25 an individual on $45,000 would face an average tax rate of 12.6 per cent, while someone on $190,000 would face an average tax rate of 27.6 per cent.

  — Projections of the share of tax paid by the top tax bracket and the top 1, 5, 10 and 20 per cent of taxpayers suggest that these will remain broadly similar under the Government's changes compared with 2017-18.

Pages 1-2 and 6 do not contain material in the scope of the request and have been deleted

Table 2: Share of personal income tax paid by the top 1%, top 5%, top 10% and top 20% of taxpayers

Cohort	% of tax paid in 2017-18	% of tax paid in 2024-25 without the plan (2017-18 settings)	% of tax paid in 2024-25 with the full plan
Top 1%	16.7	15.6	17.0
Top 5%	32.7	31.6	32.9
Top 10%	44.6	43.4	44.0
Top 20%	60.6	59.5	59.5

Budget and fiscal impact

- It is important that the Government continues to build fiscal buffers over time. Accounting for the proposed tax cuts, Government net debt is projected to fall to zero over the medium term, providing a strong fiscal buffer for Australia. The underlying cash balance (UCB) is projected to record surpluses through to the end of the forward estimates and build steadily to 1 per cent of GDP by 2026-27.

- It is important to consider the pace at which this is achieved and the mix of tax and spending measures to achieve it.

- The total turnaround in the underlying cash balance between 2013-14 and 2019-20 is already significant and is expected to be $55.5 billion or 3.4 per cent of GDP. Increasing the pace of consolidation would pose risks to the economic outlook when Australia is facing possible headwinds from the global economy.

- On the issue of composition, the Government does not want to rely on an ever increasing tax burden through bracket creep to achieve consolidation. Although delaying or reversing tax cuts might appear to accelerate fiscal consolidation, doing so would be undesirable as it would lead to higher average and marginal tax rates for workers.

  - Higher personal income tax rates reduce the efficiency of the economy and the tax system – and do so at an increasing rate. That is because every additional dollar of revenue at the higher tax rate causes a greater loss of activity than the dollar generated at the lower tax rate.

  - The loss of economic activity will affect the supply side of the economy through lower labour force participation/employment, and the demand side through lower household consumption. And because the level of employment affects the return to capital, delaying the tax cuts will put downward pressure on investment.

  - In the short term, the Government's personal income tax relief measures will increase aggregate household income by around $8 billion each year over the forward estimates period, which is equal to around ¾ per cent of 2017-18 household income.

  - This will help support consumption growth, along with continued low interest rates, continued growth in employment and increasing wage growth. The Budget forecast for consumption growth is 2¼ per cent in 2018-19, picking up to 2¾ per cent in 2019-20 and 3 per cent in 2020-21.

- Given that household consumption makes up around 60 per cent of the economy, this will in turn support economic growth.
- Lower marginal tax rates will also increase the financial return from work. Higher take-home pay may encourage some workers to re-enter the workforce, or seek additional hours.

- The medium term payments projections assume a continued responsible approach to new spending. Payments continue to grow in the medium term but at a sustainable rate. In the Budget, payments as a share of GDP are projected to decline.
  - Payments projections are made from the bottom up and assume no policy change. This builds in on-going commitments to spending in all major program areas, including health, education, Defence and income support.
  - The decline in payments as a share of the economy has been driven by lower than expected payments across a range of programs in the forward estimates, flowing through to the medium term. These include lower demand for income support payments as recipients take advantage of stronger labour market conditions, reducing their dependence on government programs.
  - Strong Budget surpluses are projected to reduce Government debt which lowers public debt interest expense, further reducing payments. This has been supported by falls in government bond yields.

Cost of the personal income tax cuts and bracket creep

- Without the tax cuts, average tax rates and tax revenues would increase.
  - Bracket creep is a feature of Australia's progressive personal income tax system. Under this system, taxpayers will face higher average, and sometimes marginal, tax rates over time when they experience income growth.
  - Chart 2 shows that in the absence of tax cuts, bracket creep has resulted in average tax rates increasing over time, and without further change average tax rates are projected to continue to increase.
  - Treasury calculations suggest that without any personal income tax cuts, average personal income tax rates would be projected to reach their 1999-00 peak by 2024-25.

Table 3: Budget impact of the 2019-20 Budget tax cuts over the forward estimates

	Costing				
Revenue/receipts ($m)	**2019-20**	**2020-21**	**2021-22**	**2022-23**	**Total to 2022-23**
Total – Lower Taxes for Hard-working Australians	**-3,450**	**-3,700**	**-3,750**	**-8,640**	**-19,540**
From 2018-19 to 2021-22, increase low and middle income tax offset*	-3,450	-3,700	-3,750	-3,850	-14,750
From 2022-23, increase low income tax offset and threshold from $41,000 to $45,000				-4,790	-4,790
From 2024-25, reduce marginal tax rate from 32.5 to 30 per cent	-	-	-	-	-

*This offset will be available for the 2018-19, 2019-20, 2020-21, and 2021-22 income years, and will be received as a lump sum on assessment.

- The tax cuts announced in the 2019-20 Budget will reduce revenue by $158 billion over the period from 2019-20 to 2029-30.

Table 4: Projected revenue impact of the 2019-20 Budget tax cuts by component – 2019-20 to 2022-23 and 2019-20 to 2029-30

	Total to 2022-23 $b	Total to 2029-30 $b
From 2018-19 to 2021-22, increase low and middle income tax offset	-15	-15
From 2022-23, increase low income tax offset and threshold from $41,000 to $45,000	-5	-48
From 2024-25, reduce marginal tax rate from 32.5 to 30 per cent	-	-95
Total	-20	-158

Implications of reversing/delaying later stage tax cuts

- If the later stages of the tax cuts are delayed or not enacted, the expected outcome is a less efficient economy and tax system.
- The announced tax cuts would reduce bracket creep by resetting and removing some brackets.
- Higher personal income tax rates reduce the efficiency of the economy and the tax system – and do so at an increasing rate. That is because every additional dollar of revenue at the higher tax rate causes a greater loss of activity than the dollar generated at the lower tax rate.
- Bracket creep therefore makes the economy and tax system less efficient. So the longer we delay adjustments to counter bracket creep, the greater the loss of efficiency in the economy and tax system.
- Although delaying or reversing the tax cuts might appear to accelerate fiscal consolidation, doing so would be undesirable.
  - The delay will lead to higher average and marginal tax rates for workers. This will cause an increasing amount of GDP to be sacrificed to pay down debt.
  - Raising tax rates would not lead to a reduced country risk premia – even though the latter is commonly put forward as a reason to pursue fiscal consolidation. IMF analysis

suggests the reduction in country risk premia that would be achieved by a faster pace of consolidation would not be sufficient to overcome the costs of a loss of economic efficiency due to higher tax rates.

- The loss of economic activity will affect the supply side of the economy through lower labour force participation/employment, and the demand side through lower household consumption. And because the level of employment affects the return to capital, delaying the tax cuts will put downward pressure on investment.

- Although the tax cuts would not be implemented for some time, announcing them today will stimulate greater investment today. That is because investment is based on the expected return to capital. Forward announcement of tax cuts is therefore expected to increase participation/employment, consumption and the return to capital.

Treasurer infrastructure speech – Key points on tax cuts

The Government has delivered further tax relief for hard-working Australians, as announced in the 2019-20 Budget. The additional tax relief is now law and will deliver a further $158 billion in tax relief by enhancing the Personal Income Tax Plan first announced in the 2018-19 Budget.

The Government has enhanced the Low and Middle Income Tax Offset (LMITO), which means that low- and middle-income earners will receive tax relief of up to $1,080 or up to $2,160 for dual income couples, with the additional tax relief applying from the 2018-19 income year. The enhanced LMITO will assist over 10 million Australians, with about 4.5 million taxpayers with incomes between $48,000 and $90,000 receiving the full benefit for 2018-19.

The Government's personal income tax relief measures will increase aggregate household income by around $8 billion each year over the forward estimates period. This will help support consumption growth, and given that household consumption makes up around 60 per cent of the economy the Government's plan will help support economic growth.

In 2024-25, the government will reduce the 32.5 per cent tax rate to 30 per cent. This will accompany the abolition of the 37 per cent tax bracket. This longer term structural reform will deliver a simpler tax system with only three tax rates. Australians earning between $45,000 and $200,000 will face a marginal tax rate of 30 per cent. As a result of the Government's plan, around 94 per cent of Australian taxpayers are projected to face a marginal tax rate of 30 per cent or less in 2024-25.

- The labour market has been particularly strong in recent years. While a slowing from recent strong rates of employment growth is forecast, the unemployment rate is expected to remain at around 5 per cent over the Budget forward estimates period.
- It is worth noting that the Budget forecasts are underpinned by a range of technical assumptions, including market expectations of interest rate cuts totalling 50 basis points.

Slide 4 – Contributions to consumption growth

- The Budget forecasts are also consistent with all announced Government policy.
- In terms of the tax cuts, it is worth exploring the outlook for household consumption in more detail. Household consumption accounts for around 60 per cent of the economy.
- Household consumption growth moderated in the second half of 2018. Consumption of discretionary items was particularly soft, including for those that relate to housing market conditions, such as household furnishings and motor vehicles.
- As a result, in the Budget the forecast for consumption growth was downgraded to 2¼ per cent in 2018-19.
- Household consumption growth is forecast to pick up to 2¾ per cent in 2019-20 and 3 per cent in 2020-21, underpinned by continued growth in employment and increasing wage growth. Household disposable income and consumption growth are also expected to be supported by continued low interest rates and the Government's personal income tax relief measures.
  - The Government's personal income tax relief measures will increase aggregate household income by around $8 billion each year over the forward estimates period, which is equal to around ¾ per cent of 2017-18 household income.
  - This will ease cost of living pressures and support consumption growth. Given that household consumption makes up such a significant share of the economy, this will in turn support economic growth.
- Lower marginal tax rates will also increase the financial return from work. Higher take-home pay may encourage some workers to re-enter the workforce, or seek additional hours. This is particularly relevant for primary carers of young children, who have to balance the returns from working with the cost of finding alternative child care.

Pages 1 and 3 do not contain material in the scope of the request and have been deleted

Will the Government be able to maintain surpluses if it locks in this tax plan and economic conditions deteriorate?

- With current global economic headwinds, now is the time to reduce taxes and provide certainty about the taxes individuals will face in future. It is also important that the Government continues to build fiscal buffers over time.
- Accounting for the proposed tax cuts, Government net debt is projected to fall to zero over the medium term, providing a strong fiscal buffer for Australia. The underlying cash balance is projected to record surpluses through to the end of the forward estimates and build steadily to 1 per cent of GDP by 2026-27.
- It is important to consider the pace at which this is achieved and the mix of tax and spending measures to achieve it.
- The total turnaround in the underlying cash balance between 2013-14 and 2019-20 is already significant and is expected to be $55.5 billion or 3.4 per cent of GDP.
- Increasing the pace of consolidation would pose risks to the economic outlook when Australia is facing possible headwinds from the global economy.
- The Government's personal income tax relief measures will increase aggregate household income by around $8 billion each year over the forward estimates period, which is equal to around ¾ per cent of 2017-18 household income.
  - It is appropriate that, in an environment where the Reserve Bank is cutting the cash rate to stimulate economic activity, household incomes are being supported by tax cuts.
- This will help support consumption growth, along with continued low interest rates, continued growth in employment and increasing wage growth. The Budget forecast for consumption growth is 2¼ per cent in 2018-19, picking up to 2¾ per cent in 2019-20 and 3 per cent in 2020-21.
- Given that household consumption makes up almost 60 per cent of the economy, this will in turn support economic growth.

Will the enhanced plan help grow the economy?

- The Government expects that the tax cuts will support consumption growth and improve incentives to work.
  - For instance, workers may choose to work additional hours or seek a promotion in the knowledge that their additional income will be taxed at a marginal tax rate of 30 per cent rather than 37 per cent (excluding the Medicare levy).
- As acknowledged in Budget Statement 2, amongst other things, household disposable income and consumption growth are expected to be supported by the Government's personal income tax relief.
- The Government's personal income tax relief measures from both the 2018-19 and 2019-20 Budget will increase aggregate household income by around $8 billion each year over the forward estimates period, which is equal to around ¾ per cent of 2017-18 household income.
- An increase in household income will support consumption growth along with continued low interest rates, continued growth in employment and increasing wage growth. The Budget forecast for consumption growth is 2¼ per cent in 2018-19, picking up to 2¾ per cent in 2019-20 and 3 per cent in 2020-21.
  - Given that household consumption makes up around 60 per cent of the economy, this will in turn support economic growth.
- On the 21st of May 2019, during the RBA Economic Outlook and Monetary Policy speech Philip Lowe said "[The RBA] are expecting household disposable income to grow at an average rate of 4 per cent over the next couple of years, which is noticeably higher than the average of recent times. Stronger growth in income will help, **but the more important factor is some tax relief**. … the tax offsets for low- and middle-income earners announced in the recent budget will boost disposable income. … Our expectation is that the stronger growth in disposable income will flow through into household spending."
- On the 2nd of July 2019, RBA Governor Phillip Lowe said "[the RBA is] expecting stronger growth in household disposable income over the next couple of years, partly due to the expected implementation of the low and middle income tax offset."

Will the enhanced plan increase consumption?

- As acknowledged in Budget Statement 2, amongst other things, household disposable income and consumption growth are expected to be supported by the Government's personal income tax relief.
- The Government's personal income tax relief measures from both the 2018-19 and 2019-20 Budget will increase aggregate household income by around $8 billion each year over the forward estimates period, which is equal to around ¾ per cent of 2017-18 household income.
- An increase in household income will support consumption growth along with continued low interest rates, continued growth in employment and increasing wage growth. The Budget forecast for consumption growth is 2¼ per cent in 2018-19, picking up to 2¾ per cent in 2019-20 and 3 per cent in 2020-21.
  - Given that household consumption makes up around 60 per cent of the economy, this will in turn support economic growth.

Are the tax cuts the best way to encourage consumption?

- The Government's personal income tax relief measures from both the 2018-19 and 2019-20 Budgets will increase aggregate household income by around $8 billion each year over the forward estimates period, which is equal to around ¾ per cent of 2017-18 household income.
- Household disposable income is the main factor that determines household consumption. Therefore increasing household disposable income, for example through tax cuts, is the most effective way to encourage increased consumption.
- Household disposable income can also increase as a result of a number of other factors, including increased employment, wage growth and increased social assistance benefits.
  - However, because the Government is able to directly determine personal income taxes, tax cuts are one of the most effective policy levers available to increase disposable income, and therefore support consumption.
  - Given that household consumption makes up almost 60 per cent of the economy, this will in turn support economic growth.
  - In addition to reducing the amount of tax payable on existing incomes, tax cuts can encourage more people to work, or to work more, which also supports economic growth more broadly.
- The tax cuts form part of our plan that is delivering a stronger economy and record job creation.

Won't consumers spend the tax cuts on overseas goods, reducing the benefit to the Australian economy?

- The Government believes in lower taxes, which is why we are putting more money in people's pockets. We trust Australians can look after their own money and to spend it on what they think is most important to them.
- Because households are free to consume goods and services from both domestic and overseas providers, we would expect that the increase in household disposable income from tax cuts will partly be spent on imports.
- But the tax cuts are also be expected to support domestic activity. This is partly due to the domestic spending that will occur directly as a result of the increase in household disposable income, and partly because it can have positive confidence effects on households.
  - Further, the purchase of imported goods can support the domestic economy by creating demand for the services required to supply the goods to Australians. This may include freight or retail services, if the imported good is bought from an Australian vendor.

Has the Government modelled the broader economic benefits of the enhanced plan?

- As with all Government decisions, the tax relief measures have been incorporated into the economic forecasts in the 2019-20 Budget. These forecasts are constructed using a range of information, including macroeconometric models.
  - As acknowledged in Budget Statement 2, the Government's personal income tax relief measures are expected to support household disposable income and consumption growth over the forecast period.
- As household consumption accounts for almost 60 per cent of the economy, support for consumption growth in turn supports GDP growth.
- On the 21st of May 2019, during the RBA Economic Outlook and Monetary Policy speech Philip Lowe said "[The RBA] are expecting household disposable income to grow at an average rate of 4 per cent over the next couple of years, which is noticeably higher than the average of recent times. Stronger growth in income will help, **but the more important factor is some tax relief.** … the tax offsets for low- and middle-income earners announced in the recent budget will boost disposable income. … Our expectation is that the stronger growth in disposable income will flow through into household spending."
- On the 2nd of July 2019, RBA Governor Phillip Lowe said "[the RBA is] expecting stronger growth in household disposable income over the next couple of years, partly due to the expected implementation of the low and middle income tax offset."

PERSONAL INCOME TAX PLAN

FOI 2558
Document 5

Key Message:

- The Government is providing lower taxes for hard-working Australians. Our tax relief measures will support stronger consumption growth and economic growth.

Key Facts And Figures:

- The Government has legislated the additional tax relief announced in the 2019-20 Budget, building on the Personal Income Tax Plan from the 2018-19 Budget.
- The Government has more than doubled the low and middle income tax offset (LMITO). Low- and middle-income earners will receive a benefit of up to $1,080, or $2,160 for dual income couples. This increased tax relief applies from the 2018-19 income year. Taxpayers will receive their offset as a lump sum on assessment after they lodge their tax returns, which they can do now.
  - Over 10 million taxpayers are expected to receive some benefit, with 4.5 million taxpayers receiving the full benefit for 2018-19.
  - Eligible individuals who lodged a tax return and received an assessment prior to the Bill receiving Royal Assent will receive any increase to the LMITO they are entitled to through an amended assessment. Taxpayers will not have to request an amendment to their assessment to access the increased LMITO. The ATO is doing this automatically as it will be able to identify returns that need to be amended.
  - As of 16 July 2019, 1.6 million people had already lodged their tax returns.
- These tax cuts mean that hard-working Australians will have more money in their pockets to spend in the economy, save or invest.
- In 2022-23 we are locking in the additional benefit to low- and middle-income earners by increasing the top threshold of the 19 per cent tax rate from $41,000 to $45,000 and increasing the low income tax offset from $645 to $700.
- In 2024-25 we are reducing the 32.5 per cent rate to 30 per cent.
  - This increases reward for effort by ensuring a projected 94 per cent of taxpayers face a marginal tax rate of no more than 30 per cent in 2024-25.
- In 2024-25, around 13.3 million taxpayers are estimated to benefit as a result of the Government's personal income tax relief measures.
- Disciplined fiscal management has allowed the Government to build on its Personal Income Tax Plan, providing $158 billion in tax relief in this year's Budget. This is on top of the $144 billion in tax cuts legislated in last year's Personal Income Tax Plan.
- Progressivity is maintained with the top five per cent of taxpayers projected to pay around one third of all personal income tax in 2024-25. This is broadly similar to that cohort's share if 2017-18 rates and thresholds were left unchanged.

Pages 2-3 and 5-7 do not contain material in the scope of the request and have been deleted

QTB Number	QB19-000056	**Adviser**	s 22
Contact Officer	s 22	**Contact Number**	(02) s 22
Division responsible	Individuals and Indirect Tax Division		
Office Responsible	Treasurer	**Date of Update**	17 July 2019

KEY SENSITIVITIES

ATO systems

- ATO online services and client portals are now fully available, following the resolution of an issue on 12 July 2019. The issue did not impact the processing of already lodged returns in any way.

Benefits to the economy

- The Government's personal income tax relief measures from both the 2018-19 and 2019-20 Budget will increase aggregate household income by around $8 billion each year over the forward estimates period, which is equal to around ¾ per cent of 2017-18 household income.

- An increase in household income will support consumption growth along with continued low interest rates, continued growth in employment and increasing wage growth. The Budget forecast for consumption growth is 2 ¼ per cent in 2018-19, picking up to 2 ¾ per cent in 2019-20 and 3 per cent in 2020-21.

  – Given that household consumption makes up around 60 per cent of the economy, this will in turn support economic growth.

- On the 21st of May 2019, during the RBA Economic Outlook and Monetary Policy speech Philip Lowe said "[The RBA] are expecting household disposable income to grow at an average rate of 4 per cent over the next couple of years, which is noticeably higher than the average of recent times. Stronger growth in income will help, but the more important factor is some tax relief. … the tax offsets for low- and middle-income earners announced in the recent budget will boost disposable income. … Our expectation is that the stronger growth in disposable income will flow through into household spending".

Affordability

- A number of stakeholders have raised concerns that the additional tax cuts are fiscally unaffordable, and will prevent the budget from reaching a surplus.

  – The tax relief is fully accounted for over the forward estimates and medium-term, with the underlying cash balance returning to surplus in 2019-20 and sustained surpluses projected over the medium term.

- A number of stakeholders have raised concerns that the Government will need to cut payments to fund the tax cuts.

  – The medium term payments projections assume a continued responsible approach to new spending. Payments continue to grow in the medium term but at a sustainable rate.

  – The Budget builds in on-going commitments to spending in all major program areas, including health, education, Defence and income support. These major spending programs are projected to continue to grow over the medium term, while public debt interest payments are projected to decline due to strong Budget surpluses reducing Government debt.

Progressivity

- The Government's plan will maintain a progressive tax system which ensures that those with the greatest ability to pay contribute a larger share of personal income tax revenue.

- Those earning $200,000 earn 4.4 times someone on $45,000 but will pay around 10 times more tax in 2024-25 when the Government's enhanced plan is fully implemented.

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Document 6

TREASURY MINISTERIAL SUBMISSION

05 June 2019 PDR No. MS19-001138

Treasurer

ECONOMIC EFFECTS OF THE PERSONAL INCOME TAX CUTS

TIMING: Your Office requested this briefing urgently.

KEY POINTS

- The personal tax relief measures announced in the 2018-19 and 2019-20 Budgets will support household incomes. This increase in incomes is expected to support household consumption, and therefore economic growth.

- The Government's personal income tax relief measures from both the 2018-19 Budget and the 2019-20 Budget will increase aggregate household income by around $8 billion each year over the forward estimates period, which is equal to around ¾ per cent of 2017-18 household income.

- An increase in household income will support consumption growth, along with continued low interest rates, continued growth in employment and increasing wage growth. The Budget forecast for consumption growth is 2¼ per cent in 2018-19, picking up to 2¾ per cent in 2019-20 and 3 per cent in 2020-21.
  - Given that household consumption makes up around 60 per cent of the economy, this will in turn support economic growth.

- The support for consumption from income tax cuts is occurring at a time of relatively soft consumption growth.
  - Consumption growth slowed noticeably in the second half of 2018, partly reflecting the downturn in the housing market. Consumption of discretionary items was particularly soft, including for those that relate to housing market conditions, such as household furnishings and motor vehicles.
  - Reflecting this weakness, the forecast for consumption growth in 2018-19 was downgraded in both the 2018-19 MYEFO and the 2019-20 Budget.

- There are risks around the outlook for consumption growth. One key risk is around the outlook for the housing market, in particular the extent to which housing prices fall, and the extent to which this continues to weigh on consumption.
  - In addition, a more subdued outlook for household income, or a further tightening in credit conditions, could constrain household spending amid high levels of household debt.

- It is appropriate that, in an environment where the Reserve Bank is cutting the cash rate to stimulate economic activity, household incomes are being supported by tax cuts.

s 22 [redacted]

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Consultation: Individuals and Indirect Tax Division.

2. (e) Household consumption and tax cuts

Consumption and forecasts

- Household consumption accounts for around 60 per cent of the economy.
- Household consumption growth moderated in the second half of 2018. Consumption of discretionary items was particularly soft, including items that relate to housing market conditions, such as household furnishings and motor vehicles.
  - As a result, in the Budget the forecast for consumption growth was downgraded to 2¼ per cent in 2018-19.
- Household consumption growth is forecast to pick up to 2¾ per cent in 2019-20 and 3 per cent in 2020-21, underpinned by continued growth in employment, increasing wage growth, continued low interest rates, and the Government's personal income tax relief measures.

Impact of tax cuts

- The personal income tax relief measures announced in the 2018-19 and 2019-20 Budgets will increase aggregate household income by around $8 billion each year over the current forward estimates period, or by around ¾ per cent of 2017-18 household income.
- An increase in household income will support growth in household consumption, and therefore economic growth.

Expected timing of impacts

- The tax relief measures are expected to support household consumption and economic growth within the forecast period. However, there is a risk that the components announced in the 2019-20 Budget will not be legislated by 1 July, when taxpayers will be able to file 2018-19 tax returns and claim the Low and Middle Income Tax Offset (LMITO).
  - $530 of the maximum LMITO amount of $1,080 has already been legislated, so the economic benefit of this boost to household disposable income will begin to be realised in the September quarter this year.
  - The timing of the economic benefit of the remaining LMITO will depend on when the enabling legislation is enacted, and the time required for the Australian Taxation Office to update its systems and amend individuals' tax returns to provide additional refunds, where applicable.

Behavioural responses

- Individuals' behavioural responses to the LMITO will vary, so there is a high degree of uncertainty around the way that households in aggregate will use the offset.
  - The ratio of household debt to disposable income is at a historic high (190 per cent) and consumer risk aversion has been rising for more than a year, suggesting that some consumers may pay down debt or save their additional disposable income rather than spend it.

- However other consumers, particularly those with low incomes, have a high marginal propensity to consume (MPC), and are likely to spend more of their additional income.

Marginal propensity to consume

- The MPC refers to the expenditure response of consumers to changes in income. For example, an MPC of 0.5 means the consumer spends 50 cents of each additional dollar of income.
  - Australian and international literature has found that MPCs can vary for different types of households and different types of income, as well as in response to the macroeconomic environment.
  - MPCs tend to be higher for households that have low incomes, are liquidity constrained, or are under financial stress.
  - MPCs also tend to be higher when income gains are permanent (for example, due to a change to income tax thresholds) compared with one-off payments.
- In order to factor the Government's enhanced tax relief measures into the economic forecasts in the Budget, Treasury took into account MPCs from literature and evidence about the impact of past tax cuts in Australia.
  - Treasury used an MPC designed to reflect the likely consumer responses to the tax measures, given the macroeconomic environment.
  - Households' actual average MPC may be lower or higher than estimated in the Budget. For example, consumer behaviour may vary with changes in economic conditions.