# Annex C Examples of budget constraints and effective marginal tax rates

This annex contains a set of figures depicting the budget constraints and effective marginal tax rates (EMTRs) faced by various single income support payment (ISP) recipients (distinguishing between those with and without children), including:

* those in public housing (PH)
* those receiving Commonwealth Rent Assistance (CRA)
* and those who do not receive any housing assistance (HA).

These figures were generated using PCTT 2014, a model of the Australian tax and transfer system built by the Commission (BP 2, annex A). An example of how to interpret the figures (for Disability Support Pension recipients) is provided in BP 2.

As explained in BP 2, the figures only take into account the effects of the main ISPs, the tax system and housing assistance on financial incentives to work. Many other factors potentially influence an ISP recipient’s decision to work — not least, the costs associated with working, like transport and childcare. As PC (2015) illustrates, for example, out‑of‑pocket childcare costs have a marked effect on a single parent’s take home pay net of those costs, taxes and ISP withdrawal. Analysis of the extent to which housing assistance affects recipients’ employment rates is presented in BP 5 and chapter 3.

The Australian tax and transfer system is complex. In addition to housing assistance, movements in the schedules below are influenced by ISP income tests and withdrawal rates, Family Tax Benefit income tests and withdrawal rates, whether an ISP is taxable, marginal tax rates, tax offsets (low income tax offset, beneficiary tax offset and or, senior and pensioners tax offset), the Medicare levy and Medicare levy reductions.[[1]](#footnote-1)

In the following charts:

* The budget constraints show the annual market income and the annual disposable income post rent available to an ISP recipient.
* Market rent is assumed to be $10 000 per annum ($192 per week). The same rent is used in each example to facilitate comparisons across the different types of ISPs. The level of market rent does not affect EMTRs for CRA recipients. For public housing tenants, market rent affects the income range over which rent setting rules contribute to EMTRs. The higher the market rent, the larger the market income range over which public housing rent setting contributes to EMTRs.
* For recipients of Parenting Payment, if the parent has one child they are assumed to be 5 years old. If they have two children, one is assumed to be 5 years old, and the other younger than 5 years.[[2]](#footnote-2) For all other cases, children are assumed to be 10 years old.
* For recipients of Youth Allowance, the budget constraints and EMTRs are calculated based on the rates paid to students living separately from their parents.

Comparing the different ISP recipients, those without children tend to face higher EMTRs (because of higher ISP withdrawal rates). That said, EMTRs faced by Parenting Payment recipients are at least 50 per cent over a large range of income — creating a large financial disincentive for this group too.

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| Figure C.1 Single, childless Newstart recipient**a,b** |
| |  | | --- | | This chart displays the budget constraint for a single, childless Newstart recipient, illustrating their market income and disposable income post rent under different housing assistance scenarios, assuming market rent is $10 000 per annum. | |
| This chart displays the effective marginal tax rates for a single, childless Newstart recipient at different levels of market income and under different housing assistance scenarios. |
| a A key to changes in the height of the EMTR schedule — indicated by numbers in the figure above — for a welfare recipient who does not receive housing assistance is presented in table C.1. The same changes affect the schedules for housing assistance recipients. Differences between the schedules for welfare recipients who do and do not receive housing assistance reflect the effects of that assistance on EMTRs. b This figure is slightly different from the version presented in chapter 2 of volume 1 because of revisions to the treatment of the beneficiary tax offset. |
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| Table C.1 Key to changes in the height of the EMTR schedules in figure C.1 |
| |  |  | | --- | --- | | No. | Cause of change in the height of the EMTR schedule | | 1 | ISP withdrawal starts at a rate of 50 cents in the dollar | | 2 | ISP withdrawal rate changes to 60 cents in the dollar | | 3 | Medicare levy starts at a rate of 10 per cent of taxable income (market income less ISP withdrawn) in excess of $20 542 | | 4 | Low income tax offset reaches its maximum level. Income tax and reductions in the beneficiary tax offset now affect take home pay | | 5 | Beneficiary tax offset reduces to zero | | 6 | Medicare levy drops to 1.5 per cent of taxable income | | 7 | ISP withdrawal ends | | 8 | Marginal tax rate increases to 32.5 cents in the dollar and reduction of the low income tax offset starts at a rate of 1.5 per cent of taxable income | | 9 | Low income tax offset reduces to zero | |
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| Figure C.2 Single, childless Youth Allowance (Student) recipient**a** |
| |  | | --- | | This chart displays the budget constraint for a single, childless Youth Allowance (Student) recipient, illustrating their market income and disposable income post rent under different housing assistance scenarios, assuming market rent is $10 000 per annum. | |
| This chart displays the effective marginal tax rates for a single, childless Youth Allowance (Student) recipient at different levels of market income and under different housing assistance scenarios. |
| a A key to changes in the height of the EMTR schedule — indicated by numbers in the figure above — for a welfare recipient who does not receive housing assistance is presented in table C.2. The same changes affect the schedules for housing assistance recipients. Differences between the schedules for welfare recipients who do and do not receive housing assistance reflect the effects of that assistance on EMTRs. |
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| Table C.2 Key to changes in the height of the EMTR schedules in figure C.2 |
| |  |  | | --- | --- | | No. | Cause of change in the height of the EMTR schedule | | 1 | Medicare levy starts at a rate of 10 per cent of taxable income (market income less ISP withdrawn) in excess of $20 542 | | 2 | ISP withdrawal starts at a rate of 50 cents in the dollar | | 3 | ISP withdrawal rate changes to 60 cents in the dollar | | 4 | Low income tax offset reaches its maximum level. Income tax and reductions in the beneficiary tax offset now affect take home pay | | 5 | Medicare levy drops to 1.5 per cent of taxable income | | 6 | Beneficiary tax offset reduces to zero | | 7 | ISP withdrawal ends | | 8 | Marginal tax rate increases to 32.5 cents in the dollar and reduction of the low income tax offset starts at a rate of 1.5 per cent of taxable income | | 9 | Low income tax offset reduces to zero | |
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| Figure C.3 Single Newstart recipient with one dependent child**a** |
| |  |  |  | | --- | --- | --- | | |  | | --- | | This chart displays the budget constraint for a single Newstart recipient with one dependent child, illustrating their market income and disposable income post rent under different housing assistance scenarios, assuming market rent is $10 000 per annum. | | This chart displays the effective marginal tax rates for a single Newstart recipient with one dependent child, at different levels of market income and under different housing assistance scenarios. | | |
| a A key to changes in the height of the EMTR schedule — indicated by numbers in the figure above — for a welfare recipient who does not receive housing assistance is presented in table C.3. The same changes affect the schedules for housing assistance recipients. Differences between the schedules for welfare recipients who do and do not receive housing assistance reflect the effects of that assistance on EMTRs. |
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| Table C.3 Key to changes in the height of the EMTR schedules in figure C.3 |
| |  |  | | --- | --- | | No. | Cause of change in the height of the EMTR schedule | | 1 | ISP withdrawal starts at a rate of 40 cents in the dollar | | 2 | Low income tax offset reaches its maximum level. Income tax and reductions in the beneficiary tax offset now affect take home pay | | 3 | Beneficiary tax offset reduces to zero | | 4 | Marginal tax rate increases to 32.5 cents in the dollar and reduction of the low income tax offset starts at a rate of 1.5 per cent of taxable income | | 5 | Medicare levy starts at a rate of 10 per cent of taxable income (market income less ISP withdrawn) in excess of the Medicare levy low income threshold for this ISP recipient of $37 523 | | 6 | ISP withdrawal ends | | 7 | Medicare levy drops to 1.5 per cent of taxable income | | 8 | Family Tax Benefit part A withdrawal starts | | 9 | Family Tax Benefit part A withdrawal ends | | 10 | Low income tax offset reduces to zero | |
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| Figure C.4 Single Parenting Payment recipient with one dependent child**a** |
| |  |  |  | | --- | --- | --- | | |  | | --- | | This chart displays the budget constraint for a single Parenting Payment recipient with one dependent child, illustrating their market income and disposable income post rent under different housing assistance scenarios, assuming market rent is $10 000 per annum. | |  |   This chart displays the effective marginal tax rates for a single Parenting Payment recipient with one dependent child, at different levels of market income and under different housing assistance scenarios. | |
| a A key to changes in the height of the EMTR schedule — indicated by numbers in the figure above — for a welfare recipient who does not receive housing assistance is presented in table C.4. The same changes affect the schedules for housing assistance recipients. Differences between the schedules for welfare recipients who do and do not receive housing assistance reflect the effects of that assistance on EMTRs. |
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| Table C.4 Key to changes in the height of the EMTR schedules in figure C.4 |
| |  |  | | --- | --- | | No. | Cause of change in the height of the EMTR schedule | | 1 | ISP withdrawal starts at a rate of 40 cents in the dollar | | 2 | SAPTO withdrawal starts at a rate of 12.5 cents in the dollar. LITO reaches a maximum. Offsets no longer increase in step with income tax. Tax now paid at marginal tax rate of 19 cents in the dollar starts to affects take home pay | | 3 | Marginal tax rate increases to 32.5 cents in the dollar and reduction of the low income tax offset starts at a rate of 1.5 per cent of taxable income | | 4 | Medicare levy starts at a rate of 10 per cent of taxable income (market income less ISP withdrawn) in excess of the Medicare levy low income threshold for this ISP recipient of $49 156 | | 5 | SAPTO reduces to zero | | 6 | ISP withdrawal ends, Family Tax Benefit part A withdrawal starts. [In this analysis, the ISP does not include the Clean Energy Supplement. If that were taken into account, ISP withdrawal would end, and FTB part A withdrawal would start, at a slightly higher level of income] | | 7 | Medicare levy drops to 1.5 per cent of taxable income | | 8 | Family Tax Benefit part A withdrawal ends, then the low income tax offset reduces to zero | |
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| Figure C.5 Single Parenting Payment recipient with two dependent children**a** |
| |  |  |  | | --- | --- | --- | | |  | | --- | | This chart displays the budget constraint for a single Parenting Payment recipient with two dependent children, illustrating their market income and disposable income post rent under different housing assistance scenarios, assuming market rent is $10 000 per annum. | |  |   This chart displays the effective marginal tax rates for a single Parenting Payment recipient with two dependent children, at different levels of market income and under different housing assistance scenarios. | |
| a A key to changes in the height of the EMTR schedule — indicated by numbers in the figure above — for a welfare recipient who does not receive housing assistance is presented in table C.5. The same changes affect the schedules for housing assistance recipients. Differences between the schedules for welfare recipients who do and do not receive housing assistance reflect the effects of that assistance on EMTRs. |
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| Table C.5 Key to changes in the height of the EMTR schedules in figure C.5 |
| |  |  | | --- | --- | | No. | Cause of change in the height of the EMTR schedule | | 1 | ISP withdrawal starts at a rate of 40 cents in the dollar | | 2 | SAPTO withdrawal starts at a rate of 12.5 cents in the dollar. LITO reaches a maximum. Offsets no longer increase in step with income tax. Tax now paid at marginal tax rate of 19 cents in the dollar starts to affects take home pay | | 3 | Marginal tax rate increases to 32.5 cents in the dollar and reduction of the low income tax offset starts at a rate of 1.5 per cent of taxable income | | 4 | SAPTO reduces to zero | | 5 | ISP withdrawal ends, Family Tax Benefit part A withdrawal starts. [In this analysis, the ISP does not include the Clean Energy Supplement. If that were taken into account, ISP withdrawal would end, and FTB part A withdrawal would start, at a slightly higher level of income] | | 6 | Medicare levy starts at a rate of 10 per cent of taxable income (market income less ISP withdrawn) in excess of the Medicare levy low income threshold for this ISP recipient of $52 312 | | 7 | Medicare levy drops to 1.5 per cent of taxable income | | 8 | Low income tax offset reduces to zero | |
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1. Smaller payments received by many income support recipients, for example, the Pharmaceutical Allowance and Clean Energy Supplement are not included in ISPs used in this analysis. The Clean Energy Supplement is included in Family Tax Benefit part A payments. [↑](#footnote-ref-1)
2. These assumptions reflect the fact that the receipt of Parenting Payment is dependent on the age of a recipient’s youngest child, and the fact that the level of FTB part B depends on whether a child is younger or older than 5 years. [↑](#footnote-ref-2)