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Income tax in Australia's tax system

Busting the myth that Australia collects too much income tax

Australia is a low-tax country. Only eight of the 38 OECD nations collect less tax as a portion of gross domestic product (GDP) than Australia. Claims that Australia collects a high portion of income tax rely on statistics that exclude other countries' social security contributions, even though these are described by the OECD as a "tax on labour income". If these contributions are included, Australia collects the OECD's 7th lowest portion of income tax to GDP.

Discussion paper

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Summary

One of the most common myths about Australia’s tax system is that it collects too much income tax. Despite repeated claims by business groups that Australia needs to reduce the share that income tax makes up of total tax revenue, the reality is that Australia is a low-tax country when compared with other developed (OECD) countries, and one of the least reliant on income taxes. Of the 38 developed nations, Australia collects the ninth lowest amount of tax as a proportion of gross domestic product (GDP), and the seventh lowest level of income tax—provided that “income tax” is taken as including Social Security Contributions (SSCs).

The inclusion of SSCs is crucial, because the argument that Australia is over-reliant on income tax relies on an overly narrow definition of income tax—specifically, a definition that excludes SSCs, a form of tax with which many Australians are unfamiliar. While they do not exist in Australia, SSCs are levied by almost all other developed countries to assist in the funding of a wide range of social benefits—these can include unemployment benefits; accident, injury, and sickness benefits; old age and disability pensions; and the provision of various hospital and medical services.

Importantly, SSCs work in a similar way to income tax: they are levied on gross income (and often just on employment earnings), withheld at payroll, and reduce workers’ take-home pay. They are categorised as taxes on labour income by the OECD and excluding them from considerations of income tax level is at best mistaken and at worst disingenuous.

When SSCs *are* included in calculations of income tax levels, it becomes very clear that claims of Australia being over-reliant on income tax do not stand up to scrutiny. In reality, Australia sits well below the OECD average in terms of both income tax levels and the overall amount of tax collected.

Introduction

One of the more commonly stated points about Australia's tax system is that it is over-reliant on income tax. Such claims are often made by representatives of business groups, such as Innes Willox, the Chief Executive of the Australian Industry Group, who stated recently:

> We're amongst the highest, most reliant countries in the world on income tax to fund government coffers. I think we run only second to Denmark of developed countries in our reliance on income tax.[1]

This claim has been made so often, and faced so little rebuttal, that many in the media repeat it as though it is an uncontested fact. For example, a recent report on ABC Online stated, "In short: Australia relies heavily on income tax to support everyday services."[2]

This claim is not only incorrect; it is asserted to push a highly political argument, which is that a large reliance on income tax reduces the incentive to work, and thus income tax should be lowered.[3] Again, this idea is often stated as if it were uncontested fact, when in reality, it is the subject of vigorous debate and research.[4] However, the merits (or lack thereof) of this argument are only worth considering if its basic premise—that Australia's level of income tax is disproportionately high when compared to similar developed countries—is correct.

This paper, therefore, focuses only on the central claim that Australia is over-reliant on income tax compared other developed (OECD) nations. In doing so, it examines the OECD's own data about how much tax its 38 member countries collect and finds that Australia in fact falls well below OECD averages, both in terms of total tax burden and in terms of income tax levels.

[1] Willox (2024) *Stage 3 tax cuts: Do changes make economic sense?*, ABC Radio National Breakfast, 24 January, https://www.abc.net.au/listen/programs/radionational-breakfast/stage-3-tax-cuts-does-a-redesign-make-economic-sense-/103382482

[2] Ziffer (2024) *'It's not just unfair but immoral': Why experts say Australia's tax system is broken and what can be done to fix it,* https://www.abc.net.au/news/2024-02-12/tax-reform-unavoidable-income-tax-workers-ageing-population/103445138.

[3] Oliver (2024) *Oliver's insights*, https://www.amp.com.au/insights-hub/blog/investing/olivers-insights-australias-tax-system

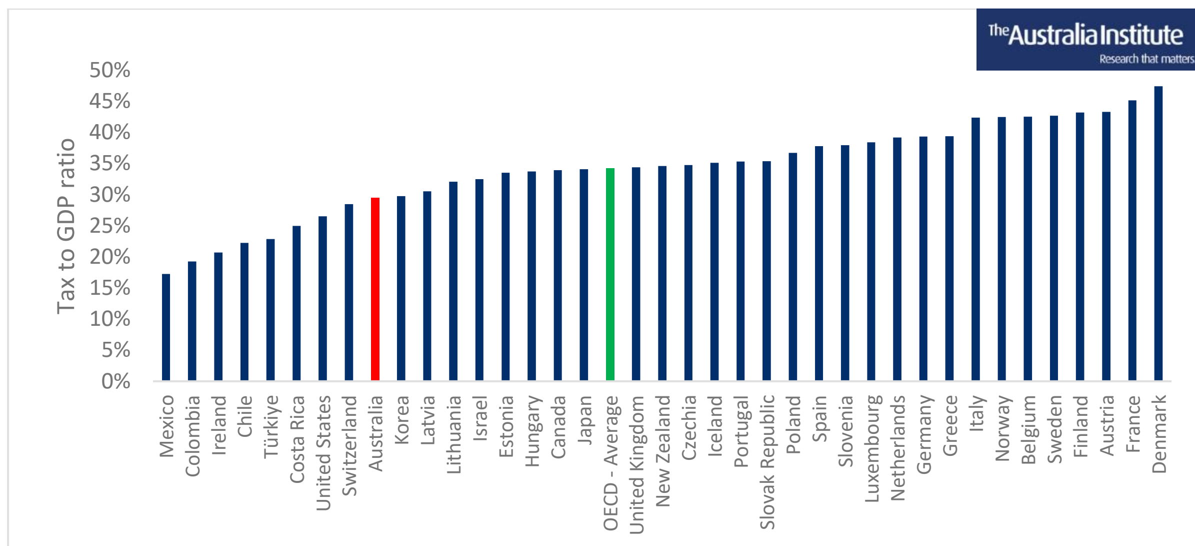
[4] Dalamagas & Kotsios (2008) *Personal Income Tax: Incentive or Disincentive to Work Effort?*, https://www.cairn.info/revue-economique-2008-4-page-777.htm

Australia is a low tax country

In terms of total tax burden, Australia is one of the lowest-taxing countries among OECD nations.

When comparing taxation levels in different countries, the most common method is to look at the amount of tax collected as a proportion of GDP, a metric that is also known as the tax to GDP ratio. In 2021, the most recent year for which data is available, Australia's tax to GDP ratio in 2021 was the ninth lowest among the OECD's 38 member countries. This is shown in Figure 1.

Figure 1: OECD countries ranked by tax revenue to GDP ratios, 2021



Source: OECD (2023) Global Revenue Statistics Database, OECD.Stat

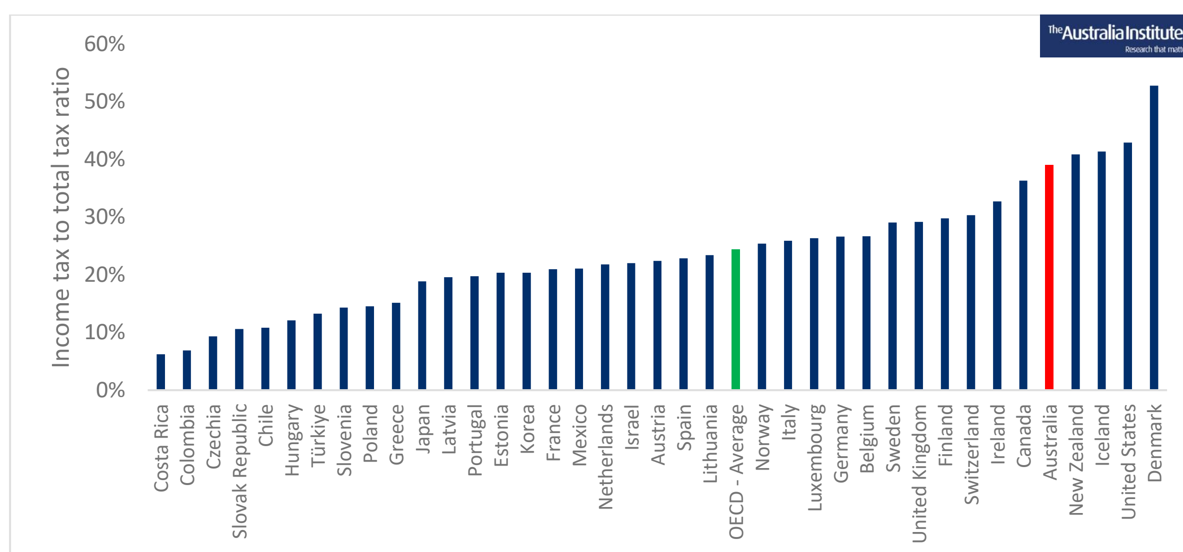
Figure 1 also shows that Australia's tax to GDP ratio was well below the OECD average, which is denoted with a green bar—Australia's ratio was 29.5%, while the average for OECD countries was 34.2%. If Australia collected the average rate of tax for the OECD, it would collect an additional $105 billion in tax each year.

Does Australia collect too much income tax?

It has been claimed by some that while Australia might be a low-tax country overall, its “heavy reliance” on income tax is, nonetheless, a problem.[5] Such arguments are often based on the claim that Australia raises more income tax as a proportion of total tax than almost all other OECD nations.

The problem with this metric should be immediately apparent: by definition, it depends on how much tax a country collects overall. This problem is demonstrated by Figure 2 below, which shows the tax on income, profits, and capital gains for individuals as a proportion of all taxes collected for each OECD nation. (For the sake of convenience, these taxes are referred to collectively as “individual tax” for the remainder of this section.)

Figure 2: OECD countries ranked by tax on income, profits, and capital gains for individuals as a proportion of all taxes, 2021

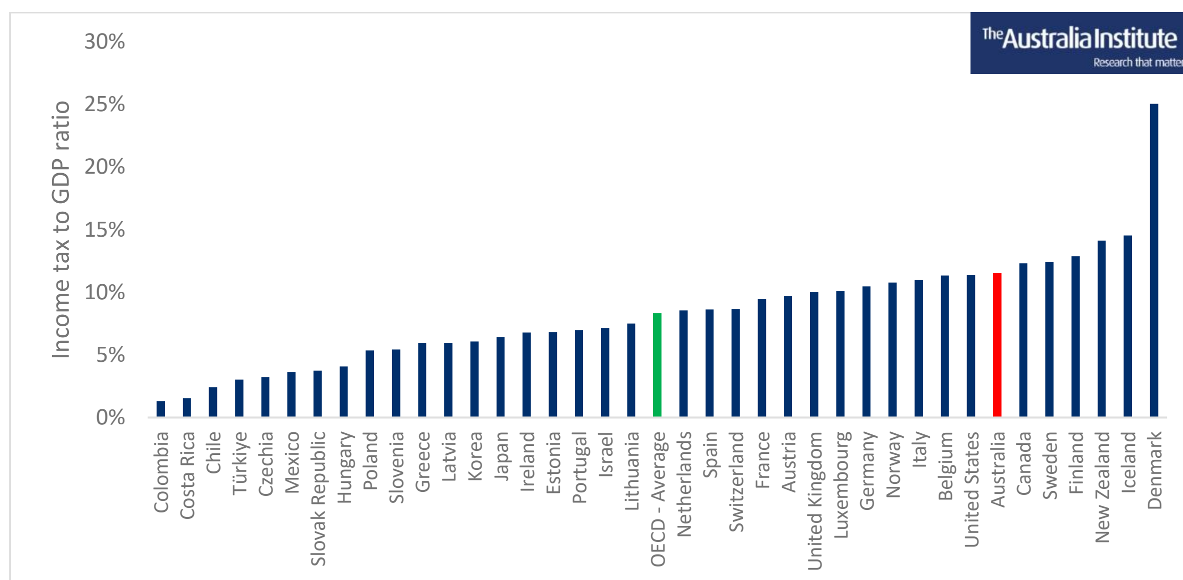


Source: OECD (2023) Global Revenue Statistics Database, OECD.Stat

Figure 2 shows that by individual tax as a proportion of total tax, Australia ranks fifth highest of the OECD countries, just behind some odd bedfellows in tax statistics—the United States and Denmark. Naively, one might look at this chart and conclude that the USA’s “reliance” on income tax is second only to Denmark’s. In reality, of course, this is not at all the case, as Figure 3 below demonstrates.

[5] Ziffer, op. cit.

Figure 3: OECD countries ranked by tax on income, profits, and capital gains for individuals as a proportion of GDP, 2021



Source: OECD (2023) Global Revenue Statistics Database, OECD.Stat

Figure 3 is based on the more common and informative metric, i.e., the proportion of individual tax as a proportion of GDP. It shows that Denmark's reliance on income tax is over twice that of the USA's. It does, however, continue to suggest Australia ranks highly in its reliance on individual tax. This is due to a more fundamental problem with the definition of income tax, which will be discussed in the next section.

In the meantime, another example of the problem with making comparisons between the level of a given tax as a proportion of total tax, rather than GDP, is Australia and Belgium. As Figure 1 above shows, Australia is a low-tax country (9th lowest), while Belgium is a high-tax country (6th highest). The first column of Table 1 below emphasises the difference: Australia's total tax to GDP ratio is 29.5%, while Belgium's is 42.5%.

The second column of Table 1 shows that as a proportion of GDP, both countries impose an almost identical level of individual tax: Australia's level is 11.5% of GDP, and Belgium's 11.3%. As a proportion of total tax, however, Australia appears far more reliant on this form of taxation—the difference is more than 12 percentage points, with Australia at 39% and Belgium at 26.7%.

Table 1: Australia and Belgium total tax and tax on income, profits, and capital gains for individuals as a proportion of GDP and total tax in 2021

Country	Total tax (%GDP)	Individual income tax (%GDP)	Individual income tax (%total tax)
Australia	29.5%	11.5%	39.0%
Belgium	42.5%	11.3%	26.7%

Source: OECD (2023) Global Revenue Statistics Database, OECD Stat

The difference between these columns is a stark demonstration of why the ratio of tax to GDP is the most common method of comparing tax levels between countries: it removes the distortion that can be introduced by other metrics and provides a more accurate and informative comparison.

There is also a more intuitive reason for looking at individual tax levels, in particular, as a proportion of GDP. If the concern about over-reliance on income tax is that it creates a disincentive to work, then it is the overall level of income tax that is important, not how the amount of income tax collected compares to the amount of non-income tax collected.

Including Social Security Contributions

As noted above, Figure 3 suggests that Australia's reliance on income tax remains relatively high when compared to the rest of the OECD. However, it suffers from a crucial, fundamental flaw: its income tax figures exclude social security contributions (SSCs).

SSCs are collected in all OECD nations except Australia, New Zealand and (arguably) Denmark. They work similarly to income tax: they are levied on the gross wages of employees, collected by employers at payroll, and forwarded to the government. Importantly, they reduce the take-home pay of workers—and if this reduced the incentive to work, then SSCs would have the same impact as income tax.

Some aspects of SSCs differ from country to country: for example, they can be set at a flat rate, or they can have different marginal rates across different income ranges. Some countries have a maximum annual contribution for SSCs, and some levy them on employers as well as employees. Overall, though, the fundamental idea is the same: they are taxes levied on employment income and are used to support the provision of a wide range of social benefits—unemployment benefits; accident, injury and sickness benefits; old age and disability pensions; and the provision of various hospital and medical services.

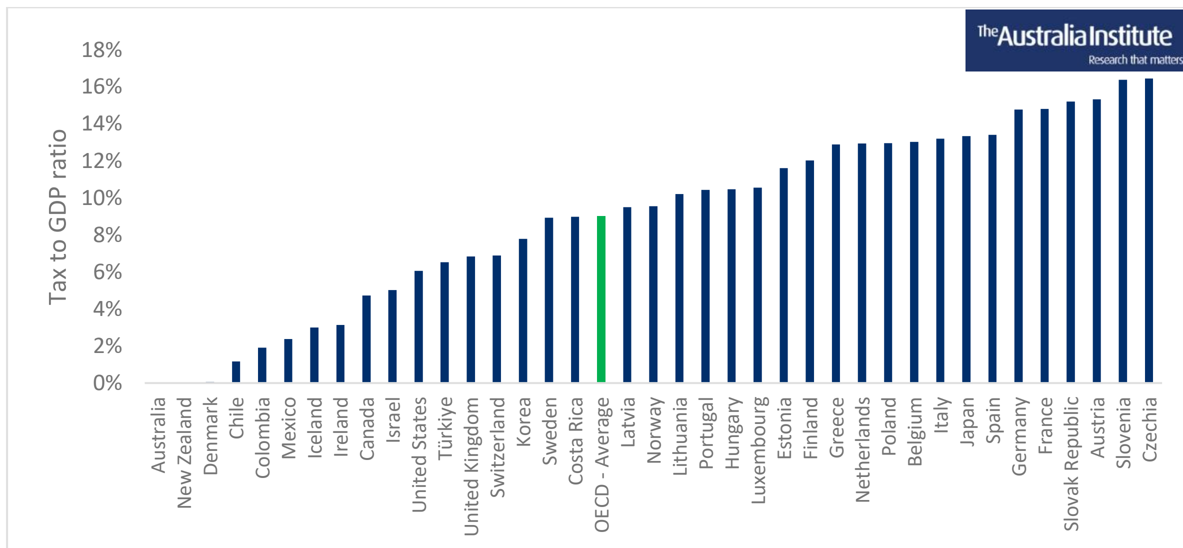
While SSCs are not called "income tax", the OECD explicitly calls them a "tax on labour income".[6] Other researchers, such as Professor Peter Whiteford of the Crawford School of Public Policy at ANU, argued in 2022 that SSCs "are very similar to income taxes. They are generally collected the same way and counted as direct taxes on households or individuals in income surveys."[7]

Figure 4 shows the SSCs collected by OECD country as a proportion of GDP. It highlights how important SSCs are for most OECD nations. It is also interesting to note that excluding SSCs from income tax calculations does not only exaggerate the importance of income tax for Australia, but it also exaggerates them for other countries. Of the six countries that rank higher than Australia in Figure 3, all but one of them collects SSCs as a proportion of GDP below the OECD average. This includes New Zealand, which like Australia does not collect SSCs.

[6] OCED (2023) *Taxing Wages – Australia*, https://www.oecd.org/tax/tax-policy/taxing-wages-australia.pdf

[7] Whiteford (2022), "Do Australians pay too much income tax? 6 charts on how we rank against the rest of the world", *The Conversation*, https://theconversation.com/do-australians-pay-too-much-income-tax-6-charts-on-how-we-rank-against-the-rest-of-the-world-185223.

Figure 4: OECD countries ranked by Social Security Contributions to GDP ratios, 2021

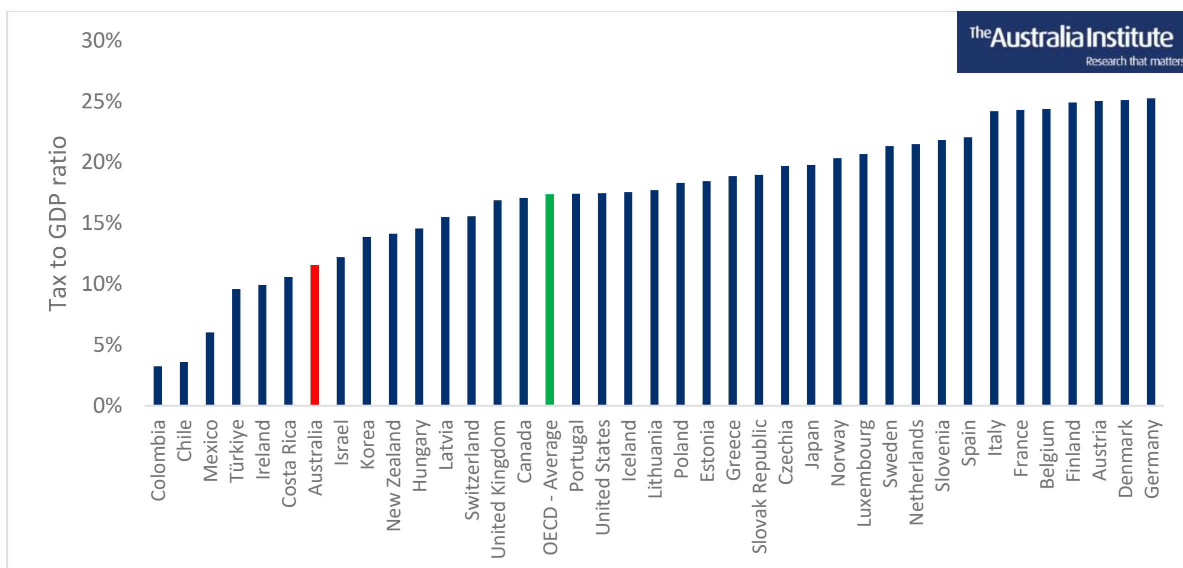


Source: OECD (2023) Global Revenue Statistics Database, OECD.Stat

Figure 4 shows that Denmark collects a very low proportion of SSCs: just 0.1% of GDP. Figures 2 and 3 above make Denmark appear to be an outlier in income tax collection, even compared to other Nordic countries. However, adjusting for SSCs brings Denmark back in line with other Nordic and European countries. This is shown in Figure 5 below, which ranks OECD countries by their level of tax on income, profits, and capital gains, *and SSCs*, as a proportion of GDP.

Figure 5 shows that by this metric, Australia raises the seventh *lowest* proportion among OECD nations of these taxes.

Figure 5: OECD countries ranked by tax on income, profits, and capital gains for individuals plus SSCs as a proportion of GDP, 2021



Source: OECD (2023) Global Revenue Statistics Database, OECD Stat. This is calculated by adding taxes on income, profits and capital gains by individuals, plus social security contributions.

Excluding SSCs from income tax figures would most likely raise questions in most OECD countries. In Australia, however, most people are unfamiliar with the concept of SSCs. It is unlikely that those making the arguments about Australia's alleged reliance on income tax, however, are unaware of SSCs' importance: the OECD specifically includes SSCs and income tax together when calculating the take-home pay of workers. For example, in its most recent briefing on Taxing Wages, the OECD concluded that:

> In Australia, the average single worker faced a net average tax rate of 23.0% in 2022, compared with the OECD average of 24.6%. In other words, in Australia the take-home pay of an average single worker, after tax and benefits, was 77.0% of their gross wage, compared with the OECD average of 75.4%.[8]

By contrast for Germany the OECD concluded:

> In Germany, the average single worker faced a net average tax rate of 37.4% in 2022, compared with the OECD average of 24.6%. In other words, in Germany the take-home pay of an average single worker, after tax and benefits, was 62.6% of their gross wage, compared with the OECD average of 75.4%.[9]

Including social security contributions when calculating the amount of tax paid by workers on their income, but then excluding them when calculating the amount of income tax levied by governments on workers, is not presenting an accurate or reasonable comparison. When an accurate or reasonable comparison *is* made, it reveals that Australia is a low-tax country that is less reliant on taxes on personal income than most nations in the OECD.

[8] OECD (2023) *Taxing Wages: Australia*, https://www.oecd.org/tax/tax-policy/taxing-wages-australia.pdf

[9] OECD (2023) *Taxing Wages: Germany*, https://www.oecd.org/tax/tax-policy/taxing-wages-germany.pdf

What about superannuation?

The revenue from Figure 5 is from taxes levied on income. Some business groups in Australia also argue that compulsory superannuation contributions are a tax that is similar in nature to SSCs.[10]

This is clearly wrong.

A tax is a compulsory unrequited payment to the government. Payments to Australia's compulsory superannuation system, by contrast, are made into the worker's own private superannuation account. While tax revenue becomes the government's property, superannuation funds always remain the worker's property. These funds can be used by the worker after retirement (and occasionally in other circumstances) and can be bequeathed to the worker's descendants.

Superannuation is thus not a tax that provides revenue to the government. Indeed, in Australia, the generous tax concessions linked to superannuation mean that funds flowing into superannuation lead to a significant *reduction* in funds flowing to the government. Superannuation is simply a form of forced, but tax-effective, saving whereby individual contributions are returned to the individual (or their descendants) with interest.

Like other tax payments, SSCs do not remain the property of the individual. Someone who does not get sick or become unemployed will get little to no benefit from SSCs, and unused SSCs are not refunded to dependents on retirement or death.

More fundamentally, the argument that superannuation payments are somehow equivalent to SSCs is ultimately irrelevant. *Even if* we were to treat compulsory superannuation payments as a tax—which, as we have seen, they clearly are not—doing so has little effect on Australia's position among OECD nations.

In 2021, total superannuation guarantee contributions in Australia were $72,635 million.[11] GDP in that year was $2,237,695 million.[12] This means that superannuation payments equate to 3.2% of GDP. Adding this to the numbers in Figure 5 gives us the numbers in Figure 6, which shows that Australia has moved up from 7th lowest to 11th lowest. This is still

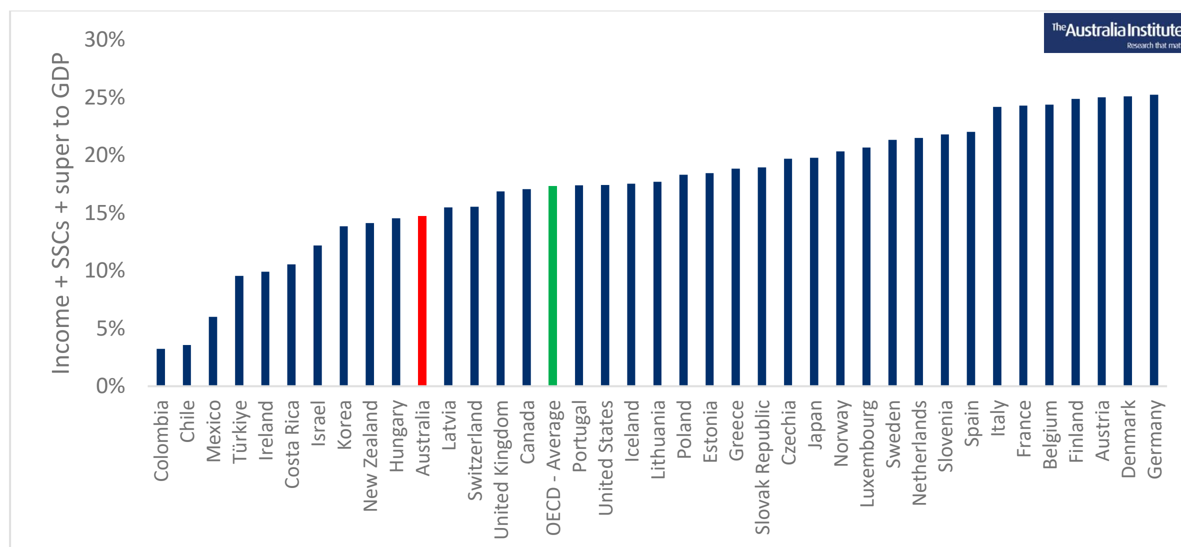
[10] Carling (2023) *Why it's a myth that Australia is a low-taxing country*, AFR, https://www.afr.com/policy/tax-and-super/why-it-s-a-myth-that-australia-is-a-low-taxing-country-20230430-p5d4c6

[11] APRA (2021) *Quarterly superannuation performance statistics – June 2021*, https://www.apra.gov.au/quarterly-superannuation-statistics

[12] ABS (2023) *Australian System of National Accounts – 2022-23*, https://www.abs.gov.au/statistics/economy/national-accounts/australian-system-national-accounts/2022-23

less than Canada, the United Kingdom, the United States, and Switzerland, and still falls in the bottom third of OECD countries.

Figure 6: OECD countries ranked by tax on income, profits, and capital gains for individuals plus SSCs to GDP ratios with compulsory super contributions added to only Australia in 2021



Source: OECD (2023) *Global Revenue Statistics Database*, OECD.Stat, ABS (2023) Australian System of National Accounts – 2022-23, APRA (2021) Quarterly superannuation performance statistics – June 2021, and authors calculations

It is important to note that compulsory superannuation contributions have only been added to Australia. Other OECD countries have schemes with compulsory contributions to private retirement savings. As each country is different it is not possible to add the compulsory contributions to each of their tax to GDP ratios. They have therefore only been included for Australia. This can be seen as a scenario in which compulsory superannuation contributions are having the largest possible effect on Australia's ranking.

Conclusion

Australia is unambiguously a low-taxing nation. Australia raises the ninth lowest amount of tax revenue out of the 38 OECD nations. In 2021 Australia's taxation revenue was equal to just 29.5% of GDP—less than South Korea (29.8%), Japan (34.1%), Canada (33.9%) and New Zealand (34.6%), let alone European nations like Germany (39.3%) and Italy (42.4%) or the Scandinavian economies of Sweden (42.7%) and Denmark (47.4%).

Neither is Australia highly dependent upon income tax. Claims to the contrary rely on semantic tricks about the definition of "income tax", tricks that are designed to exclude SSCs, and/or on calculations that use misleading and questionable criteria. When SSCs are included in calculations of income tax levels, and those calculations are made by reference to GDP—as they should be—those calculations show that Australia raises the seventh lowest level of income tax among OECD nations.

While this paper has not sought to debate the economic impact of high income tax, clearly any argument that income tax has negative economic effects must also apply to workers paying SSCs. If seeing one's pay packet reduced by withholding provided a disincentive to work, that effect would exist regardless of whether the marginal rate of tax was increased by income tax or SSCs.

If anything, the figures presented in this paper suggest that Australia should raise *more* tax than it currently does. By increasing our level of tax merely to that of Japan or Canada—two nations not generally regarded as high taxing—the government would raise an extra $100 billion each year.

Claims that Australia is over-reliant on income tax do not stand up to scrutiny. Australia sits well below the OECD average when it comes to both its level of income taxes, and the overall amount of tax it collects.