Tax Facts

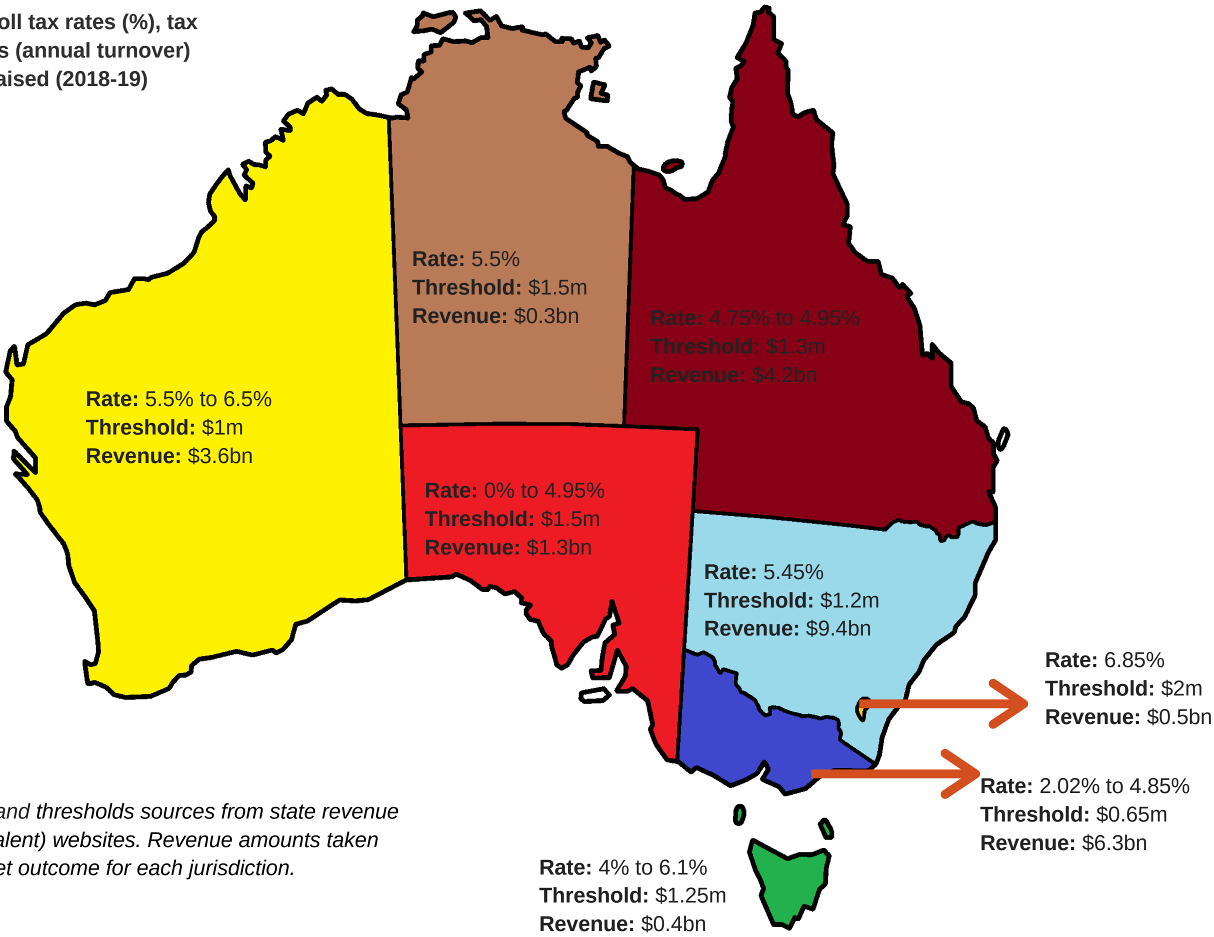
A knowledge-based series by the Tax and Transfer Policy Institute

What is Payroll Tax?

Payroll tax is a tax that is levied on the wage bill of businesses – the total money a business pays to its employees through payments like wages, salaries, fringe benefits, allowances, and bonuses. Payroll tax was first introduced in Australia by the Commonwealth Government in 1941 at a rate of 2.5 per cent. Its introduction was justified by the need to support social welfare spending – specifically, to fund the child endowment component of the new National Welfare Fund [1]. It was handed over to the states and territories (states) in 1971 in order to provide them with a growth tax [2].

Today it is the single largest 'own-source' revenue generated by the states [3]. It raised $25.8 billion in 2018-19, or around 30 per cent of state own source tax revenues and around 9 per cent of their total revenues [4]. As with other revenue bases, payroll tax receipts have declined during the COVID-19 economic downturn. Its potential as a growth tax has been frustrated by inter-state competition characterised by declining rates and increasing tax-free thresholds. Despite complaints from business operating across the country about compliance costs [5], substantive harmonisation remains elusive with payroll tax regimes varying significantly by state. The rates and thresholds in each state, as at December 2020, are given in Figure 1. This does not include the temporary relief that many states have provided to businesses in response to the 2020 economic downturn.

Figure 1: Payroll tax rates (%), tax free thresholds (annual turnover) and revenue raised (2018-19)



Source: Rates and thresholds sources from state revenue office (or equivalent) websites. Revenue amounts taken from final budget outcome for each jurisdiction.

Who bears the burden of payroll tax?

Tax Fact #11 *Tax Incidence and Elasticity* highlights the important difference between the *legal incidence* of a tax and its *economic incidence*. The legal incidence of a tax is who actually pays the tax. The economic incidence is who ultimately bears the burden of that tax.

A common criticism of payroll tax is that it is a tax on jobs. This would suggest that businesses, as well as bearing the legal incidence, also bear the economic incidence of payroll tax. As a consequence of this, it is argued, businesses will choose not to engage additional employees and, by extension, grow the business beyond a point at which they become liable for the tax.

The incidence of payroll tax in Australia has been considered at length in tax reviews at the Commonwealth and state level, including most recently in the 2020 NSW Review into Federal Financial Relations. These reviews have generally found that the ultimate incidence of the tax falls not on the business but on employees in the form of lower wages or consumers in the form of higher prices **[6] [6a]**.

Recent studies, including by the TTPI, support this, finding that payroll taxes had limited impact on firm decision making including employment and capital expenditure **[7] [7a]**.

Such reviews have also generally found payroll taxes to be one of the more efficient tax bases in the federation, similar to other taxes on labour such as the personal income tax.

What are the key challenges facing payroll tax in Australia?

Another regular complaint against payroll tax is that the need to comply with 8 different payroll tax regimes across the country imposes significant costs on business. This has led to call for harmonisation of payroll taxes across jurisdictions.

Whilst previous harmonisation efforts have resulted in some success in aligning the payroll tax base (i.e. what payroll taxes are applied to) there has been limited alignment of exemptions, rates, or thresholds.

In the context of the economic downturn and the need for the states, in time, to repair their balance sheets, the NSW Review of Federal Financial Relations has highlighted that the states 'simply cannot afford to hollow out their largest tax base'. The panel has recommended that the Board of Treasurers, a forum of state Treasurers, collectively agree a strategic national approach to payroll tax reform that addresses the hollowing out of the tax base and the complexity this imposes on taxpayers.

[1] Tilley, P. (2020a) '***Early federation reviews and 1942 income tax unification***', TTPI Working Paper, 11/2020

[2] Tilley, P. (2020b) '***Post-war tax reviews and the Asprey Blueprint***', TTPI Working Paper, 15/2020

[3] The States and Territories receive 46% of their revenue from the Commonwealth, through the GST or through distributions. See Tax Fact #13 ***Raising and Sharing Revenue***

[4] Australian Bureau of Statistics 2020, ***Taxation Revenue Australia 2018-19, cat. No 5506.0 (Table 10) and cat. No. 5512.0 (Table 1)***, ABS, April, Canberra

[5] Board of Taxation(2014) ***'Review of Tax Impediments Facing Small Business'***

[6] See for example Henry K, Harmer J, Piggott J, Ridout H, Smith G, 2009, ***Australia's Future Tax System: Report to the Treasurer***. Canberra: Commonwealth of Australia; 2009 Dec, p 294

[6a] Thodey D, English B, Anderson J, Twomey A, Freebairn J, Halton J 2020, ***NSW Review of Federal Financial Relations Final Report***, NSW Government, August 2020, Sydney, p 76

[7] See Majeed O & Sinning MG 2019, ***Do Payroll Tax Cuts for Australian Firms Affect their use of Capital and Labour***, TTPI Working Paper 8/2019, September 2019, Canberra

[7a] Ralston B 2018, ***Does Payroll Tax Affect Firm Behaviour***, Treasury Working Paper 2018-02, Treasury, Canberra

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More information

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