



# FACT SHEET

## The economic structure of the tax-transfer system

Section 3 of the 'Architecture of Australia's tax and transfer system' paper describes how the tax-transfer system affects the living standards of Australians through its impacts on the economic decisions of individuals and businesses and on the distribution of economic opportunities amongst individuals.

### Key points

- There are many taxes in Australia, all of which are ultimately paid from the earnings from only three factors of production: labour, capital and land (including natural resources).
- Individuals (rather than businesses) own these factors of production and therefore ultimately bear the burden of taxation. Who bears a tax or benefits from a transfer payment can be very different to who pays the tax or receives the payment.
- All taxes affect choices by encouraging individuals to shift from higher taxed to lower taxed goods and services or activities and by lowering their available income. Similarly, transfers can impact on people's choices by increasing available income in certain circumstances. The costs of the tax-transfer system include its impacts on these choices (economic efficiency) and the costs of administering and complying with the system. These costs are significant.
- Equity is an important objective of the tax-transfer system. There is no unanimity about how best to assess equity but two fundamental principles are: horizontal equity, which requires that individuals in the same economic circumstances pay the same tax; and vertical equity, which is generally considered to mean that those with greater capacity pay more tax than those with less capacity.
- The top 20 per cent of taxpayers are estimated to receive around 46 per cent of wage and salary income. The distribution of capital income is even more skewed, particularly dividend income and capital gains. The distribution of wealth is less equal than the distribution of income but this reflects lifecycle effects to a significant extent (that is, older Australians having accumulated wealth over their working lives).
- Australia's tax-transfer system places a relatively greater net burden on those with higher incomes. It also redistributes income from the young working age population to the retired elderly.

### Relationship between economic bases and taxes

