



# **Workforce Disincentives in Public Housing**

Shelter WA Occasional Paper 2004-1

prepared by Karel Eringa

March 2004

## Introduction

The 2003-2008 Commonwealth State Housing Agreement lists disincentives for public housing tenants as one of the major areas of work. As most public housing tenants pay an income related rent, it is assumed their effective marginal tax rates will be substantially higher than tenants in private rental and owner occupiers whose housing costs do not vary with their income.

However, in practice a number of factors impact on an individual or family's effective marginal tax rate, including taxation settings and the rate at which allowances and benefits phase out. To date little research has been done to verify to what extent tenure impacts on the incentives of a family or individual to find paid employment.

This paper uses four case studies to give an indication of the effective marginal tax rates faced by West Australian households in three tenures: public housing, private rental and owner occupation.<sup>1</sup> It focuses on the question whether current rent setting policies in public housing have produced greater workforce disincentives than in other tenures and, if so, how to redress this situation.

## Background

Public housing tenants pay 25% of their assessable income in rent. Assessable income is determined by the Department of Housing and Works as 100% of Centrelink allowances and benefits, 10% of the amount of Family Tax Benefit Part A over and above the Basic Component and 5% of Family Tax Benefit Part B. A weekly Working Allowance of \$30 is deducted from the household's income if they are in part time or full time employment.

For the purpose of the modelling, it was assumed that singles pay, on average, 80% of Perth's median rent. Similarly, couples were assumed to pay an average 90%, singles with 2 children 100% and couples with 4 children 120% of Perth's median rent. Perth median rent currently stands at \$161 per week.<sup>2</sup>

Family Tax Benefits are structured into three parts. Family Tax Benefit Part A contains a basic component that does not vary with income for incomes under \$80,000. It also contains an additional component that reduces with income. Finally, Family Tax Benefit Part B varies with the income of the secondary income earner.

**Effective Tax Rates (ETR):** Give an indication of how much a person benefits from increasing their salaried income by measuring the increase in taxation and loss of statutory benefits. The ETR does *not* include other costs of obtaining paid employment such as transport and childcare.

**Effective Marginal Tax Rate (EMTR):** The additional amount of taxation payable and income lost for an additional dollar of waged income. For instance, if your tax bill goes up by 20 cents and you lose 40 cents of Centrelink benefits when your salary increases by \$1, your EMTR would be 60%.

**Effective Average Tax Rate (EATR):** The average amount of taxation payable and income lost for a given amount of waged income. For instance, if your tax bill is \$5,000 and you lose \$10,000 of Centrelink benefits when you start a \$30,000 job, your AETR would be 50%.

---

<sup>1</sup> There is also a fourth tenure, community housing, which differs from public housing in that tenants are eligible for Commonwealth Rent Assistance. However, under current rent setting policies community housing providers appropriate any CRA its tenants may receive. This means that in practice, community housing tenants will be in the same situation with regard to effective taxation rates as public housing tenants.

<sup>2</sup> Real Estate Institute of WA, *Market Update*, December quarter 2003.

## Case Study 1: Single Person

### Effective Marginal Taxation Rates for three tenures

The first port of call in determining how much of an incentive a person has to find paid employment is to look at the person's Effective Marginal Taxation Rate (EMTR). Figure 1 below indicates the EMTR for a single person in public housing, private rental and home ownership, for salaried income between \$0 and \$80,000 per year. The figure highlights that the EMTR is different for different tenures and for different levels of salaried income, but is generally regressive.

The figure shows that for singles in all three tenures the EMTR for the first \$1,500 of salaried income is zero. This is because for these low amounts of income the person does not pay any taxes, does not lose any statutory benefits, and in public housing does not pay any extra rent (due to the working allowance).

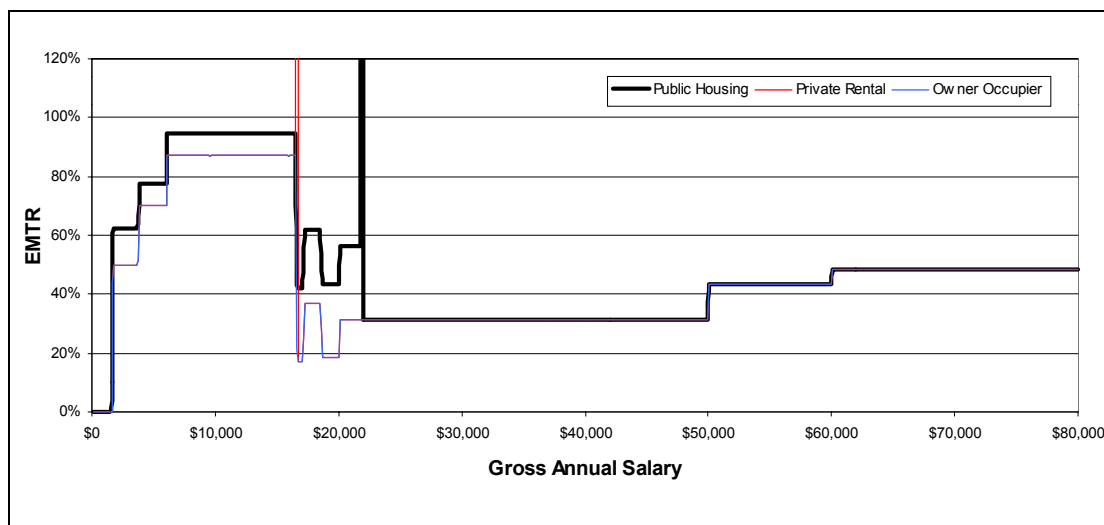


Figure 1: Effective Marginal Tax Rate, Single Person

However, after this initial breathing space, the EMTR escalates rapidly to extremely high levels. Firstly, home owners and private sector tenants start losing Centrelink benefits at a rate of 50 cents in the dollar when their income exceeds \$1,612 per year. For salaries over \$3,692 this increases to 70 cents in the dollar, and for salaries of \$6,000 and above 17% tax is also payable. Overall, home owners and private sector tenants face an EMTR of 87% for jobs with annual salaries between \$6,000 and \$16,500.

Public housing tenants are even worse off, as they pay 25 cents of every dollar of salary earned in excess of the working allowance (around \$1,560 per year). This brings their EMTR to 94.5% for the same income levels. It should be noted that the EMTR for public housing tenants is not, as is often assumed, 25% higher than for private tenants and for owners. This is due to the fact that the tenant's benefits reduce by 70 cents for each additional dollar of salaried income. In other words, the increase in household income is 30 cents for every additional dollar earned, and the corresponding increase in public housing rent is 7.5% (ie. 25% of 30%).

For employment income between \$16,500 and \$21,900, the EMTR for the three tenures follow different patterns. Firstly, for private tenants there is a spike at \$16,600. This is the point where single people lose their eligibility for various Centrelink benefits, and thus their eligibility for rent assistance. This has a dramatic effect on the tenant's disposable income after housing: the after housing disposable income for a private

tenant earning \$16,500 is \$402.93 per fortnight, falling to \$311.55 per fortnight if the tenant earns \$16,600 in waged income.

However, after this point the EMTR for private tenants falls to 17% - their marginal tax rate. Between 17,200 and 18,600 there is a smaller spike (to 37%), as the Medicare levy is phased in. Finally, for incomes above 18,600 the EMTR increases with the relevant tax brackets.

The EMTR for public housing tenants follows a similar pattern as that for private tenants, albeit at a higher level. However, for public tenants the spike does not occur at \$16,600 but at \$21,900, which is the income level at which these tenants lose eligibility for public housing. It should be noted that the height of this spike will depend on the assumptions regarding the market rent of the property – the lower the market rent, the lower the value of the rent subsidy and the smaller the spike. For instance, no spike occurs if the tenant already pays market rent at this income.

Finally, the EMTR for owner occupiers is identical to that for private sector tenants, except that there is no spike for this group at any level of employment income. This is due to the fact that owner occupiers do not receive any ongoing income subsidies.

### Effective Average Taxation Rates for three tenures

The marginal rate of effective taxation is an important factor for individuals in deciding whether to increase their involvement in the labour market. However, the effective average taxation rate (EATR) gives an indication as to the overall financial benefits of finding a job for an unemployed person.

Figure 2 shows the EATR for the three tenures. It confirms that effective taxation for all three tenures is regressive, with the EATR rapidly escalating to more than 70% for all tenures. The peak AETR for private tenants and owner occupiers occurs at an income of around \$16,500, while the peak for public housing tenants occurs at \$21,900. As expected, the peak is lowest for owner occupiers (71.5%), but surprisingly, the peak for public housing tenants (79.8%) is lower than the one for private tenants (85.9%).

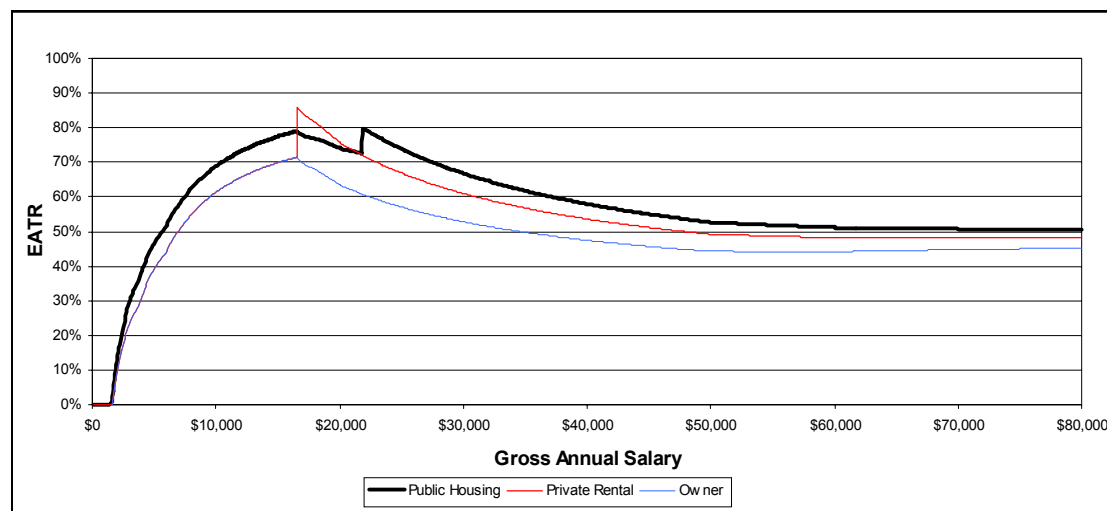


Figure 2: Effective Average Tax Rate, Single Person

In other words, the relative value of Commonwealth Rent Assistance for single people is higher than that of the public housing subsidy at the income levels at which the two payments cut out. However, the difference in effective average taxation rates between the two tenures is small in proportion to the total value of the EATR for all salary levels.

While they are in part due to the assumptions regarding the market rent, these results nevertheless emphasise that workforce disincentives in the form of effective taxation rates are high regardless of tenure.<sup>3</sup> In all three tenures, the EATR is higher than the highest income tax bracket (47.5%) for most salary levels. This is further highlighted Figure 3, which breaks down the sources of effective taxation for a single person with a full time job at the minimum wage level (\$23,400 per year) in public housing and private rental.<sup>4</sup>

Figure 3 indicates that single people in public housing have the smallest incentive to take a \$23,400 per year job. Their after housing income increases by only \$5,444 per year compared to being unemployed – an average effective taxation rate of 77%. The largest factor is the loss of Centrelink benefits, which amount to \$10,010 or 43% of the gross annual salary. Income tax accounts for 16% (\$3,751) and the loss of rent subsidies in public housing for 18% (\$4,195).

Private tenants face the same loss of Centrelink benefits and increases in taxes.<sup>5</sup> However, the financial value of the loss of Commonwealth Rent Assistance for private renters is smaller than the value of the loss of public housing for public housing sector at this particular salary level (\$2,454 compared to \$4,195).

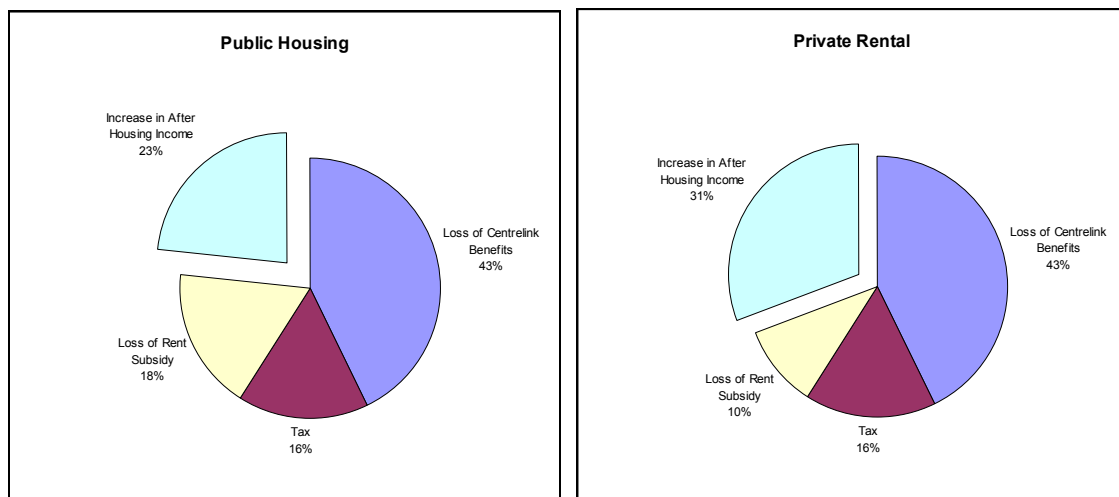


Figure 3: Source of Effective Taxation at \$23,400: Single Person

### Conclusion

In conclusion, single people in public housing, private rental and home ownership face significant financial disincentives to work. Of particular concern are the extremely high EATRs (in excess of 70%) that occur for entry level jobs. Increased taxes and loss of statutory benefits appear to be of three to six times greater significance than the loss of rental subsidies in public and private rental housing respectively. While workforce disincentives are slightly greater for public housing tenants for most salary levels, the difference with the private rental sector is marginal.

<sup>3</sup> These figures do not take account of work related expenses, such as the cost of travel to and from work. Actual financial disincentives to work will therefore be even higher than indicated by the EMTRs and EATRs.

<sup>4</sup> The breakdown for home owners is identical to the one for private sector tenants, with the exception that home owners do not face the loss of rental subsidy.

<sup>5</sup> Home owners are in an identical situation as private renters, with the exception that the loss of CRA does not apply.

## Case Study 2: Member of a Couple

### Effective Marginal Taxation Rates for three tenures

Members of a couple also face financial disincentives to work, particularly if their partner receives a statutory benefit. However, Figure 4 indicates that, in all three tenures, the EMTRs for this group are structured differently and are generally higher than those faced by single people. This is because, in addition to the financial disincentives faced by single people, members of a couple who take up paid employment also face a reduction in the statutory benefits received by their partner.

Moreover, EMTRs for this group are very high for a wider range of salaries, not falling below 40% until a salary level of nearly \$30,000 per year. The salary range between \$17,300 and \$28,000 is of particular concern for this group, with EMTRs in excess of 100% in all three tenures. This means that people in this situation lose money if they take on more work, even without taking into account the cost of getting to and from their workplace.

The EMTRs for public housing tenants are generally slightly above those for private sector tenants and home owners, due to the income related rents in this tenure. Finally, there are similar spikes in the EMTRs for public and private partnered tenants as reported for singles in these tenures. However, for members of a couple, these spikes occur almost simultaneously, at salary levels of just under \$30,000.

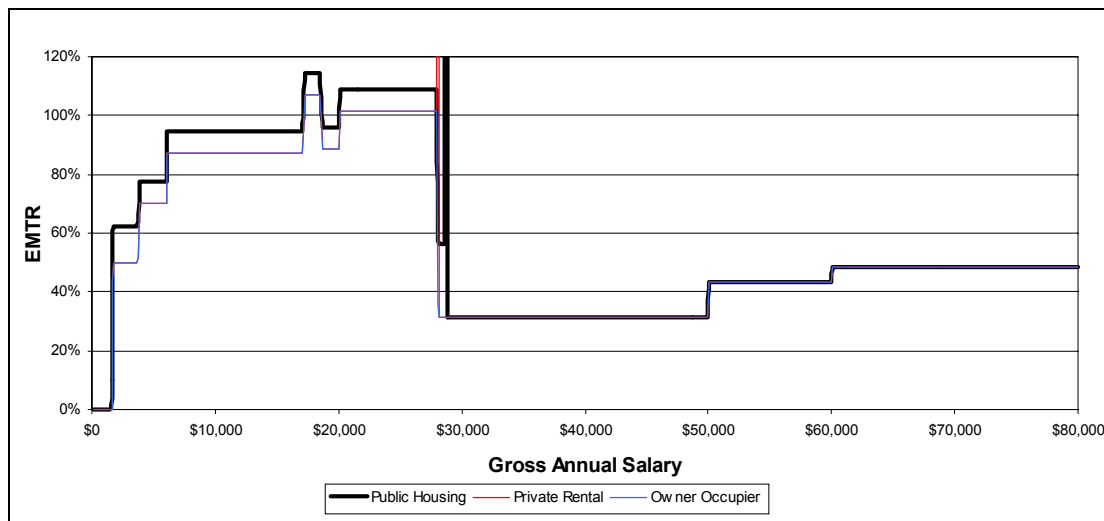


Figure 4: Effective Marginal Tax Rate, Member of a Couple

### Effective Average Taxation Rates for three tenures

Figure 5 shows that couples face higher effective taxation rates than singles in all three tenures. The EATR peaks at salary levels of around \$28,000 per year, with home owners again facing a lower peak EATR (83.1%) than both private sector tenants (91.1%) and public tenants (92.3%). However, in this case, the peak for public housing tenants is slightly higher than that for private sector tenants.

For salaries up to \$28,000 per year, the EATR for public housing tenants exceeds that for private sector tenants and home owners by around 7.5%. Beyond this level, the EATRs for private tenants and public housing tenants are very similar, as private tenants face the sudden loss of their CRA. While public housing tenants face the loss of eligibility for public housing at around the same salary level, this has a much smaller impact because the value of the rental subsidy in this sector phases out gradually.

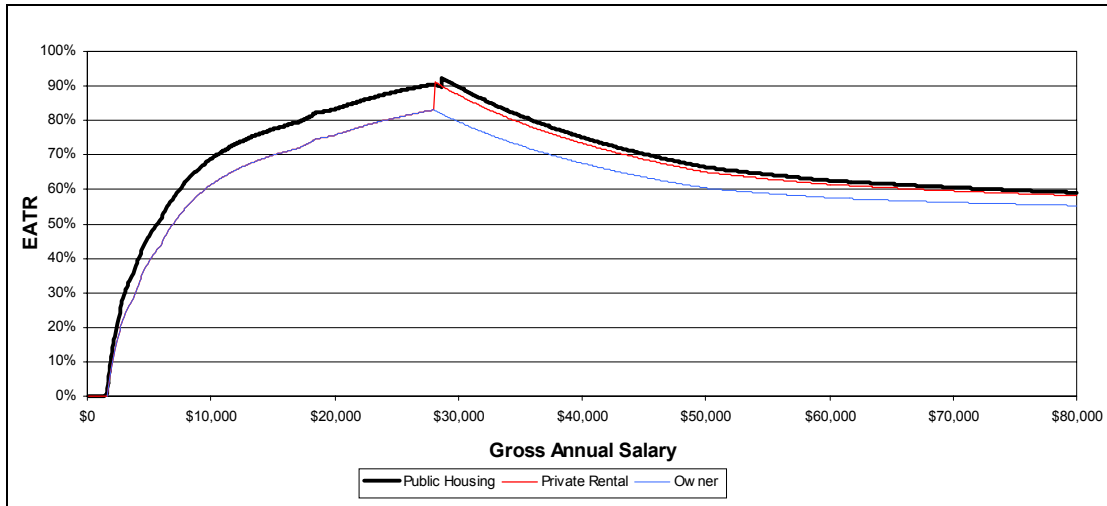


Figure 5: Effective Average Tax Rate, Member of a Couple

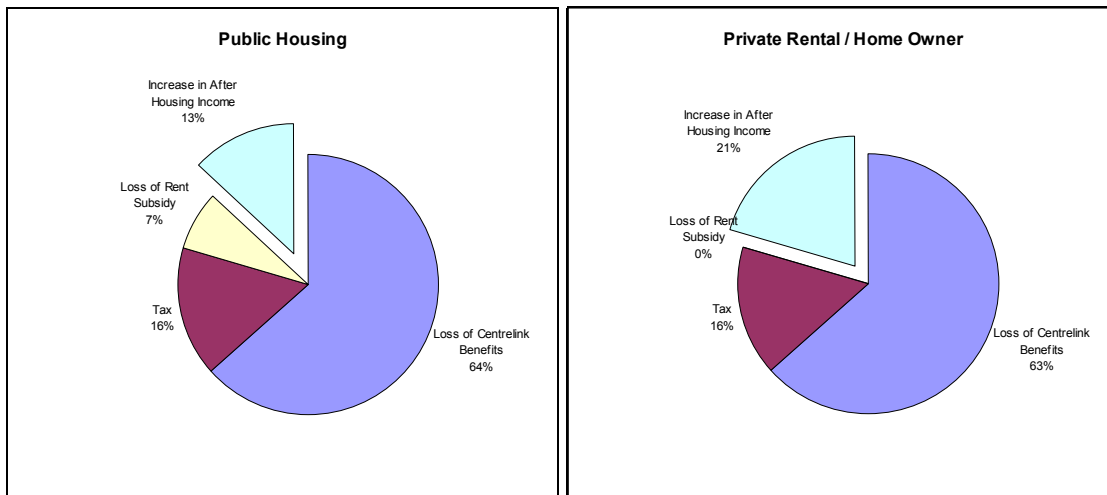


Figure 6: Source of Effective Taxation at \$23,400: Member of a Couple

Figure 6 indicates the sources of effective taxation for members of a couple for a full time job paid at the minimum wage (\$23,400 per year). At this salary level, housing consumers in all three tenures lose just under two thirds of their salary in reduced statutory benefits for themselves and their partner. They pay a further 16% of their income in taxes, bringing the EATR to 79% for both private renters and home owners. Public housing tenants face an additional loss of \$1,751 per year (7%) in increased rent, bringing their EATR at this income level to 87%.

*Conclusion*

Members of a couple face major financial disincentives to work regardless of their tenure. Of particular concern are the EMTRs in excess of 100% for most of the salary range between \$17,300 and \$28,000, resulting in EATRs of 80 to 90% for salaries of around \$28,000. As with singles, increased taxes and loss of statutory benefits appear to be of much greater significance than the loss of rental subsidies, which account for less than 10% of total financial disincentives for public housing tenants receiving the minimum wage. Finally, workforce disincentives for couples are generally slightly greater for public housing tenants. However, the difference with the private rental sector is relatively small, particularly for salaries over \$28,000.

### Case Study 3: Single Person with 2 Children<sup>6</sup>

#### Effective Marginal Taxation Rates for three tenures

The presence of children significantly changes the structure of financial disincentives to work in all three tenures. Figure 7 indicates that for salaries below \$31,700 and above \$47,200, EMTR levels for singles with 2 children follow a comparable pattern to EMTR levels for those with no children. The main difference is that, due to different policy settings, the peaks in EMTRs associated with these tenants becoming ineligible for CRA and public housing occur at higher salary levels.

However, Figure 7 shows that an important difference occurs for salaries between \$31,700 and \$47,200. In this range, Family Tax Benefits received by singles with 2 children fall by 30 cents for each dollar earned. This increases EMTRs for all three tenures from 31.5% to 61.5% between these salaries.

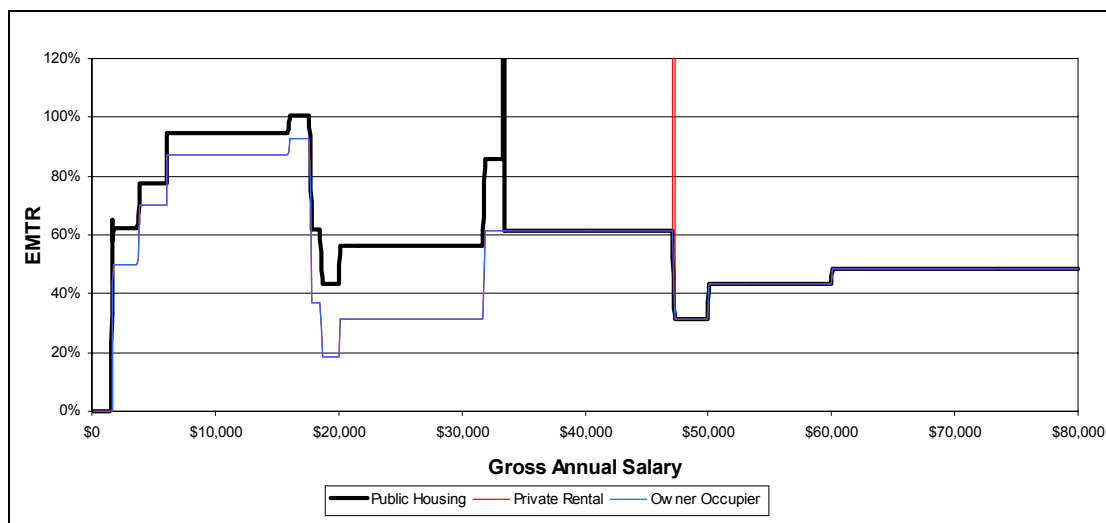


Figure 7: Effective Marginal Tax Rate, Single with 2 Children

For public housing tenants, salaries between \$17,700 (the salary at which Centrelink benefits are no longer available) and \$33,400 (the salary at which tenants become ineligible for public housing) are of concern. In this range, EMTRs for singles with 2 children are 25% higher than for private tenants and home owners. This is due to the fact that families in this situation are not eligible for any Centrelink benefits, and therefore increases in salaried income no longer reduce these benefits. As a result, the public housing rent increases by the full 25 cents for every dollar earned.

Finally, the salary range between \$16,100 and \$17,600 is of concern to single public housing tenants with 2 children. Due to the relevant policy settings, tenants in this situation face EMTRs in excess of 100%.

#### Effective Average Taxation Rates for three tenures

Figure 8 indicates that for lower salaries, Effective Average Taxation Rates for single public housing tenants with 2 children are roughly comparable with those for singles without children. However, after reaching a peak at a salary level of around \$18,000 per year, EATRs for singles with children fall much more slowly than those for singles without children. This slower decline reflects the impact of the loss of Family Tax Benefits, which occurs at salaries between \$31,700 and \$47,200.

<sup>6</sup> The subject of this case study is a single with two children. However, while the precise figures change, the general conclusions are similar for singles with one child and those with three or four children.

Another difference is that the peak associated with the tenant becoming ineligible for public housing occurs at a higher salary level and is much reduced for this group. This is due to the fact that at this point, the value of the public housing subsidy has already been reduced to just over \$200 per year as public housing rents increase.<sup>7</sup>

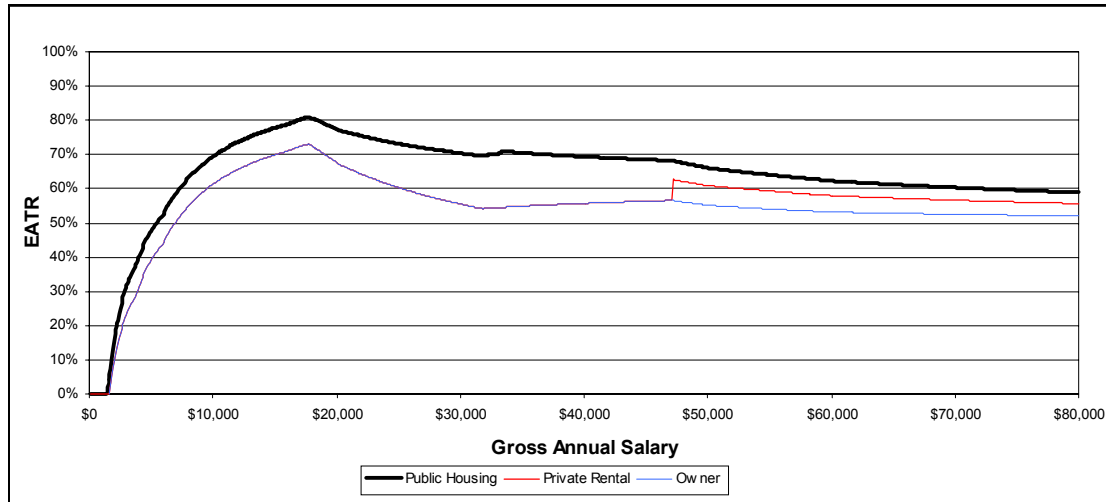


Figure 8: Effective Average Tax Rate, Single with 2 Children

Figure 8 also indicates that for salaries of \$17,700 and \$33,400 the difference between tenants in public housing and private rental grows steadily for reasons discussed in the previous section. For salaries of \$33,400 the gap is stable, until narrowing when private tenants become ineligible for Commonwealth Rent Assistance, at a salary of \$47,200. Nevertheless, the gap between public housing and private sector tenants never accounts for more than 30% of the total EATR for private sector tenants.

Finally, Figure 9 indicates the sources of effective taxation for members of a single person with 2 children for a salary that would place the family at the top of the second income quintile (currently around \$47,200 per year). At this salary level, the effective average tax rate for this family is 69% if it resides in public housing,<sup>8</sup> 63% if it lives in private rental sector and 57% if it owns the house it lives in. The loss of rental subsidies contributes 12% to the EATR for public housing tenants and 6% to that of private sector tenants.

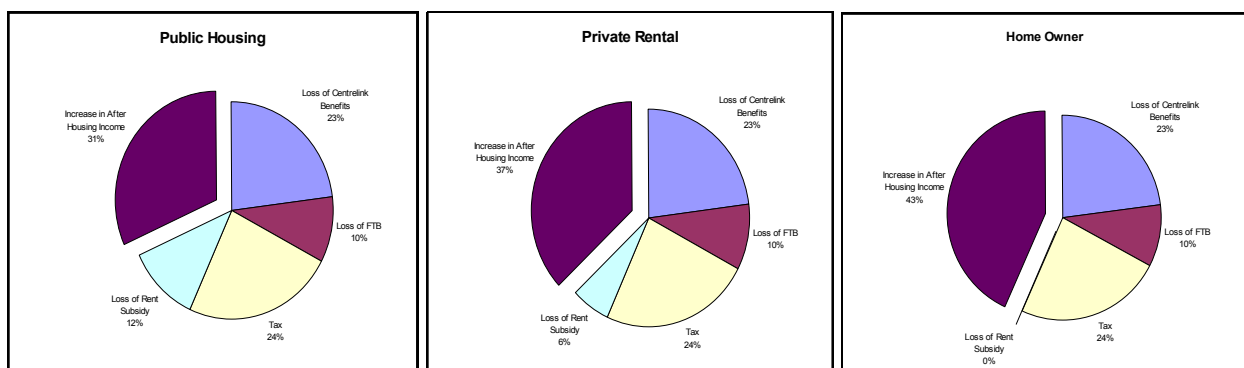


Figure 9: Source of Effective Taxation at \$47,200: Single with 2 Children

<sup>7</sup> The precise value of the public housing subsidy will depend on specific assumptions regarding market rent. However, the general point that the value of this subsidy will fall substantially, remains valid regardless of any changes in this assumption.

<sup>8</sup> The loss factors in the fact that the family will no longer be eligible for public housing at this income level.

### Conclusion

For lower salary levels (ie. below around \$18,000 per year), singles with children are in a similar situation as those without children. However, beyond this level, singles with children generally have higher effective tax rates, as in addition to the disincentives faced by those without children, singles with 2 children also face the loss of Family Tax Benefits as their salary increases.

Due to rent setting policies in public housing, public housing tenants with 2 children face significantly higher effective tax rates than their private sector counterparts, particularly for salaries between \$17,700 and \$47,200. However, this difference never accounts for more than 30% of the effective tax rate. Finally, EMTRs for this group are in excess of 100% for a small range of salaries (between \$16,100 and \$17,700).

### Case Study 4: Member of a Couple with 4 Children<sup>9</sup>

#### Effective Marginal Taxation Rates for three tenures

Figure 10 shows that couples with 4 children generally face higher effective marginal tax rates than the other family types examined in this paper. EMTRs for this group follow a similar pattern as found in the other case studies, rising rapidly for lower income ranges, then falling slowly. Of particular concern is the salary range between \$17,300 and \$28,000, where EMTRs are above 100% in all three tenures.

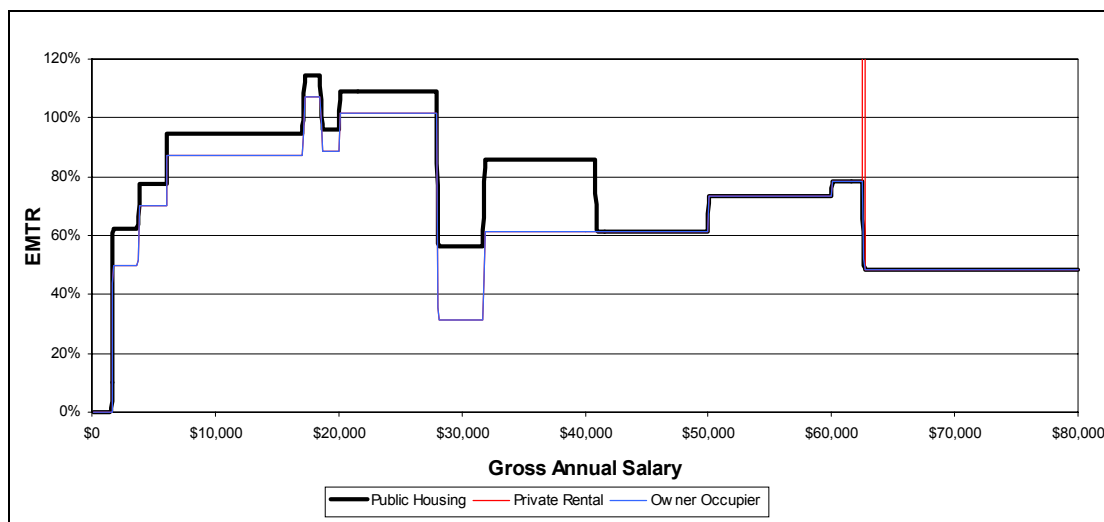


Figure 10: Effective Marginal Tax Rate, Member of a Couple with 4 Children

In addition, EMTRs for this family type fall more slowly than those for singles with 2 children, because the larger amount of Family Tax Benefit received by this family takes longer to taper off. As a result, EMTRs in all three tenures do not fall below 50% until a salary of \$62,600 is reached.

Figure 10 also indicates that EMTRs for public housing tenants are 25% above those in the other tenures for salaries between \$28,200 and \$40,800.<sup>10</sup> This is because for this income range, the family in question no longer receives any Centrelink benefits, and their public housing rent therefore rises by the full 25 cents for every dollar earned.

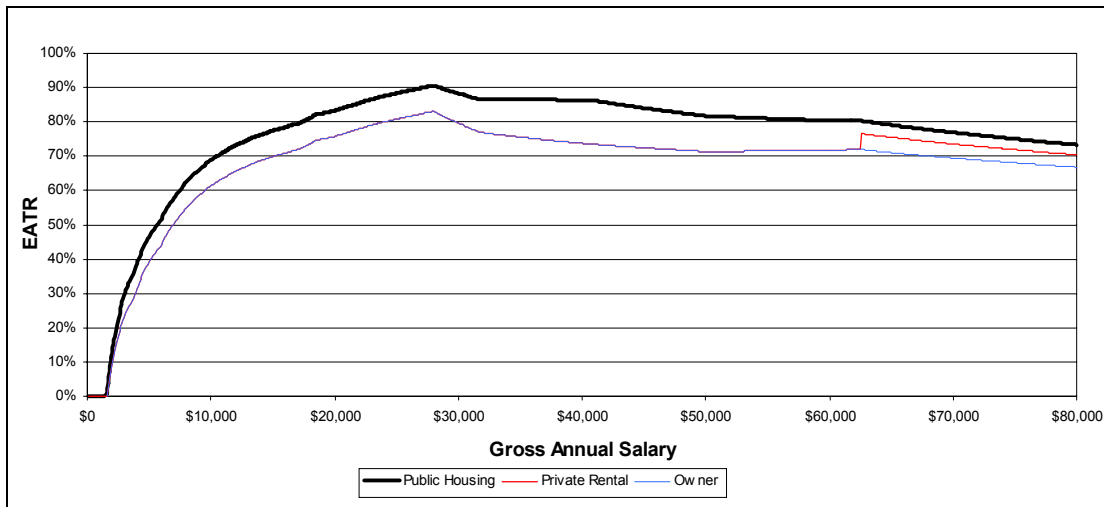
<sup>9</sup> The subject of this case study is a member of a couple with four children. However, while the precise figures change, the general conclusions are similar for couples with fewer children.

<sup>10</sup> Above \$31,700 Family Tax Benefits reduce by 10 cents per dollar earned, reducing EMTRs for public housing tenants to 24% rather than 25% above those for private sector tenants.

Finally, it should be noted that there is the spike in EMTRs associated with tenants becoming ineligible for public housing does not exist for this group. This is due to the fact that the policy of relating rents to incomes reduces the value of the public housing subsidy to zero for salary levels above \$40,800; although this group does not become ineligible for public housing until a salary of \$50,400 is reached.

*Effective Average Taxation Rates for three tenures*

Figure 11 indicates that couples with 4 children face very high effective average taxation rates for a wide range of salaries. EATRs peak at a salary of \$28,000 per year for all three tenures, reaching 90.5% for public housing tenants and 83.1% for private tenants and home owners. For higher salaries, EATRs fall very slowly, remaining above 65% for all salary levels studied in all three tenures.



**Figure 11: Effective Average Tax Rate, Member of a Couple with 4 Children**

Private sector tenants face a sharp increase in their EATR around \$62,600. At this salary level these tenants lose their eligibility for Commonwealth Rent Assistance. While the loss of this subsidy is slightly greater for a larger family in absolute (dollar) terms,<sup>11</sup> the spike in the EATR is smaller. This is because the loss occurs at a higher salary level, and is therefore relatively less significant.

It is also clear from Figure 11 that public housing tenants face significantly higher EATRs than their private sector counterparts, particularly for salary levels up to \$62,600. However, the gap between public housing and private sector tenants never accounts for more than 20% of the total EATR for private sector tenants.

Finally, Figure 12 indicates that the average effective taxation rate is very high for this family type, particularly if it resides in public housing. If a family member is offered a job that would place the family at the top of the second quintile, such a family would lose 83% of the salary in taxes and reduced statutory benefits. Lost Centrelink benefits account for 38% of this salary, increased taxes for 24% and the loss of Family Tax Benefits for a further 10%. The loss of public housing rent subsidies accounts for 11%, and the family’s after housing income increases by 17%.

<sup>11</sup> Assuming that this larger family pays a higher rent because it requires a larger house.

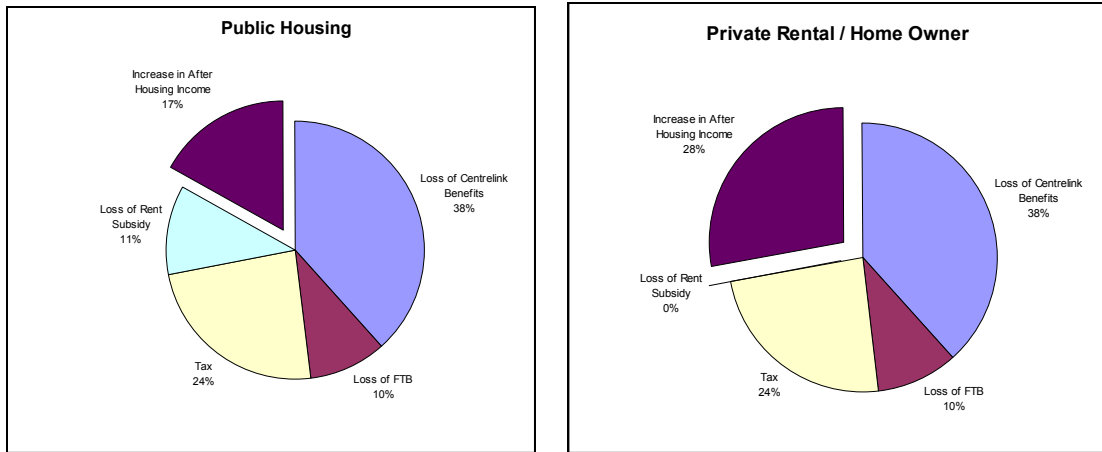


Figure 12: Source of Effective Taxation at \$47,200: Member of a Couple with 4 Children

*Conclusion*

Couples with 4 children face effective average tax rates in excess of 65% for all but very low (below around \$10,000 per year) salary levels. In addition, effective marginal tax rates are in excess of 100% for a critical range of salaries, between \$17,300 and \$28,000.

Again, due to the effect of public housing rent setting policies, couples with four children face higher effective tax rates if they live in public housing rather than private rental or their own home. However, this difference never accounts for more than 30% of the effective tax rate.

## Conclusion

The case studies detailed in this paper show that home owners, private sector tenants and public housing residents all face significant disincentives to enter the workforce due to high effective taxation rates. The case studies also indicate that high effective taxation rates largely result from lost statutory benefits and income tax; the loss of public housing subsidies is generally a minor contributor.

In all four case studies, marginal effective taxation rates for all three tenures rose rapidly after a brief initial pause, typically to levels between 80 and 100%. As a result, average effective taxation rates rose steeply to a peak between 80 and 90%. After the initial peak, effective taxation rates would decline more or less gradually, depending on the family type.

There were two main differences between the four case studies. The first difference was the point at which the peak EATR was reached. For instance, this occurred at around \$17,000 for singles with no children in private rental or home ownership, and at \$28,000 for couples with 4 children. The second main difference was the rate at which effective taxation rates decreased after reaching this peak: due to the impact of Family Tax Benefits, the decline in EATRs was much slower for singles and couples with children than for those with no children.

The case studies also highlighted some differences between tenures. Effective taxation rates were always lowest for home owners and, with some notable exceptions, highest for public housing tenants. Private sector tenants faced the sudden loss of Commonwealth Rent Assistance at a salary level that varied according to their family situation. Public housing tenants, on the other hand, faced a gradual fall in their subsidy sometimes coupled with a sudden loss of the remainder of this subsidy.

However, the difference in EATRs between public and private sector tenants was mostly relatively small, typically equating to around 10% of the private sector EATR and never accounted for more than 30% (for singles with 2 children earning a salary of \$33,400 per year).

It can be concluded that high effective taxation rates are caused primarily by the rapid loss of Centrelink benefits as salaries rise. Income tax, including the Medicare levy, is also structured in such a way as to significantly increase effective taxation rates. Along with Family Tax Benefits, public housing rent setting policies are the least important factor. Any serious attempt to improve workplace incentives for people on low incomes should therefore focus on reforming statutory benefits, the income tax structure and the way in which the Medicare levy is phased in before considering public housing rent setting policies.

Overall, the evidence presented in this paper does not justify making significant changes to the current public housing rent setting policies for singles and couples without children. Whilst such changes may marginally reduce workforce disincentives in some situations, this must be offset against the effect of such a policy change on affordability in public housing, as any alternative rent setting structure would be unlikely to guarantee affordability. In addition, any changes could only benefit the 30% of public housing tenants that are in the labour force.<sup>12</sup>

Nevertheless, there is room for improvement in public housing rent setting policies with regard to singles and couples with children, as the differences with private rental are largest here. Within this group, reform should further focus on those salary levels

---

<sup>12</sup> Kath Hulse and Bill Randolph, *Housing and unemployment: the role of housing and housing assistance in making decisions about employment*, National Housing Conference, Housing Futures, Adelaide, 26-28 November 2003, p.2: "Three in ten public tenants are in the labour force, comprising 22 per cent in work and 8 per cent who are unemployed and actively seeking work."

where tenants are no longer eligible to receive Centrelink benefits. Shelter WA suggests three measures:

1. Fully include Family Tax Benefits as income for rent-to-income purposes. Currently these benefits are only partially included. Since this would raise rent levels for people with children, it would reduce the implicit rental subsidy, thus reducing the workforce disincentive associated with removing the subsidy when a family member finds paid employment.
2. Increase income eligibility limits. It should be noted that the effect of this measure would be limited to the extent that many salary-earning families already pay market rent levels, which effectively eliminates their public housing subsidy. However, this measure would benefit singles with children and families living in areas where market rents are relatively high.
3. A more generous working allowance. Currently, Homeswest deducts \$30 per week from a tenant's income if they are in part time or full time employment. Raising this working allowance to the level of the income tax threshold (currently \$6,000 per year or around \$115 per week) would reduce effective taxation rates for entry level jobs.