

# Deductions for work-related expenses in Australia: an analysis of options for reform

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# Introduction

- ▶ Deductions for work-related expenses (WREs) have their policy basis in notions of correct measurement of taxable income
- ▶ A standard deduction has been proposed in the Australian context on the grounds that it would improve tax simplicity
- ▶ A standard deduction, by itself, is a tax policy measure that has a revenue cost

# The case for reform

- ▶ Simplifying deductions is a measure that is aligned with the objective of reducing the need for taxpayers to lodge an annual tax return
- ▶ The reform of WRE deductions still has simplicity benefits, even in a tax system that requires lodgement of annual tax returns
- ▶ The lack of regard for simplicity in past tax reform processes
- ▶ An increase in WRE deduction claims over the last few decades

# Tax policy considerations

- ▶ Complex rules for WRE deductions can outweigh the benefits of claiming them
- ▶ Standard deduction may decrease compliance complexity, and rule complexity
- ▶ Set the standard deduction at a level higher than the WRE deductions that most taxpayers currently claim
- ▶ Lower-income taxpayers claim relatively higher proportions of WREs than higher-income taxpayers

# WRE deductions and their equivalents

- ▶ WRE deductions in Australia quite generous by international standards - may have the effect of taxpayers expecting deductions for most expenses
- ▶ New Zealand phased out WRE deductions in the late 1980s
- ▶ Political risks in abolishing WRE deductions in Australia (Eccleston, 2006)
- ▶ Australia has taken the approach of limiting deductions on certain categories, rather than setting a global cap on deductions

# Options for reform of WRE deductions

- ▶ Our reform proposal is designed to achieve revenue neutrality
- ▶ Two components:
  - i) Revenue gain from imposing a cap on actual WRE deductions
  - ii) The revenue gain is the basis for the level of standard deduction
- ▶ Our analysis assumes that only taxpayers with WREs less than the standard deduction would opt for the standard deduction

# Model formulation

- ▶ The model was applied to the 2017-18 ATO 2% Sample Unit Record File of individual tax returns
- ▶ The initial analysis found 14 levels of standard WRE deductions, ranging from \$500 to \$2,370. The accompanying caps on actual WRE deductions ranged from \$15,000 to \$2,370
- ▶ The trade-off is between increased simplicity, for most taxpayers, and increased tax liability for small proportion of taxpayers with high actual WRE deductions
- ▶ As the level of the standard WRE deduction decreases, the simplicity benefits of the reform decline

	% of taxpayers	Mean taxable income	Median taxable income	Mean WREs	Median WREs	% with non-WRE deductions
<b>1) TPs with WREs &lt; \$1,160</b>	61.4%	\$55,668	\$41,105	\$306	\$230	52.3%
TPs with WREs > \$7,000	5.6%	\$114,622	\$89,788	\$12,761	\$11,634	86.2%
<b>2) TPs with WREs &lt; \$1,040</b>	59.2%	\$55,036	\$40,377	\$277	\$206	51.3%
TPs with WREs > \$8,000	4.5%	\$118,499	\$92,232	\$14,034	\$12,012	86.5%
<b>3) TPs with WREs &lt; \$830</b>	54.7%	\$53,823	\$38,892	\$224	\$160	49.1%
TPs with WREs > \$10,000	3.1%	\$123,741	\$95,983	\$16,332	\$14,191	87.2%
<b>4) TPs with WREs &lt; \$680</b>	50.9%	\$52,760	\$37,515	\$184	\$137	41.7%
TPs with WREs > \$12,000	2.3%	\$129,723	\$98,544	\$18,365	\$16,220	87.7%



# Conclusion

- ▶ Advantages of the proposed reform include improved simplicity (for taxpayers and tax administrators) and revenue neutrality
- ▶ A necessary step toward removing the need to lodge annual tax returns (for a larger proportion of taxpayers)
- ▶ Future research could consider the extent to which the cost of WREs may shift from employees to employers

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