A deep dive into a standard deduction

Eight important questions to consider about the proposed $1,000 standard deduction

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Artwork acknowledgement: Rhys Paddick, a Yamatji/Noongar digital artist from Boorloo (Perth, WA)

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He aha te mea nui o te ao?
He tāngata! He tāngata! He tāngata!

What is the most important thing in the world?
It is people! It is people! It is people!

A deep dive into the proposed standard deduction

On Sunday 13 April 2025 the Labor Party announced that, if it is re-elected, it would introduce a $1,000 standard tax deduction from the 2026-27 year.

Providing a $1,000 standard deduction for work expenses sounds simple. But designing the system is not necessarily straightforward. Consideration needs to be given to issues such as:

- What expenses will be included in the standard deduction and thus won't be claimable as a separate deduction? For example, tuition costs were considered in the Henry review to be vital to the development of human capital and productivity and were proposed to be deductible in addition to the standard deduction.
- Who will be able to claim the standard deduction? The media release refers to labour income. That clearly includes employees, but do sole traders earn labour income or business income?
- Should the $1,000 threshold be indexed to ensure that it continues to provide the compliance cost savings?
- Whether other compliance savings measures can be adopted, such as excluding payments for cars allowances based on the ATO's cents per kilometre be excluded from income so that employees who receive such allowances don't need to claim expenses against that allowance?

This paper looks to assist the consideration of the proposed standard deduction by considering a series of eight important questions. This paper does not look to support or reject the proposal, only to provide more details to assist any consideration of the proposal.

CA ANZ looks forward to working closely with the government to implement this proposal.

Susan Franks
Australian Leader – Tax, Superannuation and Financial Services

Eight important questions

Question 1: What has been announced?

The 13 April 2025 media release states that the proposed standard deduction will have the following features:

1. It will apply from 1 July 2026.

2. It will allow individual taxpayers to choose to include a $1,000 deduction in their tax return rather than calculating and claiming the actual deductible work-related expenses they incurred in the year.

3. If this choice is made no other deductions for work related expenses can be claimed, but deductions for other types of expenses can still be claimed, like deductions for gifts to deductible gift recipients or for expenses incurred in deriving investment income.

4. Choosing the standard deduction relieves the taxpayer from having any requirement to show they incurred **any** deductible work-related expenses or hold **any** substantiation (the rules in Division 900 will not apply). That is those who do not have any work-related deductions but do earn labour income will be able to claim a $1,000 standard deduction.

5. A taxpayer who does not make the choice will calculate their deductions for work related expenses as they currently do, and the deductibility of any work-related expense will still be dependent on whether they meet the substantiation requirements in for various work-related expenses (in Division 900).

6. Only taxpayers who have "labour income" in their tax return will be able to choose the standard deduction. If an individual's return has **only** investment and/or business income, then they will not be able to claim the standard deduction.

7. The expected cost of implementing this standard deduction is over $1 billion a year (2027/28 $1.1 billion and 2028/29 $1.3 billion according to the pre-election costings).

Question 2: What is the history of the standard deduction?

This is not the first time a proposal has been made to add a standard deduction into the Australian tax system.

Henry review

In 2009, the Henry Review envisaged taxpayers being *"provided with a standard deduction as part of their pre-filled tax return"* with the standard deduction as the default option that taxpayers could opt out of.

Recommendation 11 of the Henry Review proposed that:

> *A standard deduction should be introduced to cover work-related expenses and the cost of managing tax affairs to simplify personal tax for most taxpayers. Taxpayers should be able to choose either to take a standard deduction or to claim actual expenses where they are above the claims threshold, with full substantiation.*

Calculation method

The calculation of the standard deduction was proposed to be more than just a fixed amount. This Review envisaged that the standard deduction be comprised of both a nominal base amount **and** a deduction equal to a percentage of labour-related income up to a capped amount. The additional component of this proposed standard deduction was designed to reflect the fact that work related expense claims rise with income.

The review did not propose a specific nominal base amount, percentage or capped amount. However, if a standard deduction was made up of a base amount of $500 and 2% of labour income capped at $50,000 of labour income then the maximum standard deduction would be $1,500 ($500 + 2% x $50,000 = $1,500 standard deduction).

Expenses captured

The Review also consider what expenses would be captured by the standard deduction.

Tuition fees for education related to current employment were not to be included. They were to remain deductible with full substantiation. This is due to education and training being "an essential part of human capital development and a significant contributor to economic outcomes for all Australians....particularly when structural change in the economy makes re-training essential for sustainable employment."

However, the Review concluded other deductible self-education expenses (including travel expenses and educational materials) should be included in the standard deduction.

Gifts and superannuation were also to remain deductible in addition to the standard deduction.

People who received genuine and reasonable expenses in relation to their travel allowance would not be able to claim a tax deduction, BUT the allowance would not be included in assessable income. This would simplify returns and ensure that the standard deduction was appropriately applied

Other deductions which can be made against work income that were recommended for review include:

- Insurance premiums for income protection, sickness and accident.
- Investments in the Australian film industry
- Investments in forestry managed investment funds
- Costs for standing for political elections

Criteria for deductibility

In addition, the Review recommended that a tighter nexus between the deductibility of the expense and its role in producing income. In making this recommendation the review referred to the approach taken in the United Kingdom, where a tax deduction for work related expenses is only available if the employee is obliged to incur and pay the expense as holder of the employment, and if the expense is incurred wholly, exclusively and necessarily in the performance of the duties of the employment,

2010 announcement

Following this recommendation, on 11 May 2010 the government announced it would implement the following:

> *From 1 July 2012 the Government will provide individual taxpayers with an optional standard deduction of $500 in lieu of claiming work-related expenses and the cost of managing their tax affairs. The standard deduction will be increased to $1,000 from 1 July 2013.*

After issuing a discussion paper on this proposal, in the 2012/13 Budget, the then government announced it would not be proceeding with a standard deduction. The reasons given for not proceeding with this proposal were the upcoming tripling the tax-free threshold would result in one million taxpayers not having to lodge a tax return, and that this decision would deliver saving of $2.1 billion over the four-year forward estimates.

Re:Think

In 2015, the government's *Re:Think Tax Discussion Paper* considered a standard deduction and, while making no recommendation, discussed the balance between any compliance savings and the cost to revenue:

> *Given the high proportion of taxpayers who incur a relatively low total value of legitimate WREs, a 'standard deduction' could provide significant compliance savings. Rather than substantiating WRE expense claims with receipts, these taxpayers could instead choose to 'tick a box' to claim a standard deduction at a set amount (for example, $500).While it could deliver a simplicity benefit, a standard deduction would come at significant cost — people who do not currently have any WRE deductions could reduce their taxable income by the value of the standard deduction.*

Subsequent considerations

In 2017, the Economics Committee of the House of Representatives undertook an inquiry into tax deductibility that considered a standard deduction. The Committee recommended that the government maintain the current work-related deduction rules rather than introducing a standard deduction. While accepting the simplicity a standard deduction could bring, the committee rejected the standard deduction on the ground of its cost to government revenue.

In 2018, the Inspector General of Taxation, in a review titled "The Future of the Tax Profession", recommended a standard deduction:

> ***Recommendation 5.2***
>
> *The IGT recommends the:*
>
> *(a) Government consider reform of the work-related expense deduction regime, having regard to prior reviews in this area, including the possibility of introducing standard deductions with a view to eliminating the need for most individuals to lodge income tax returns;*

Since then, there have been other proposals by non-government entities for a standard deduction, some as high as $3,000. This proposal claimed that a $3,000 standard deduction could remove seven to nine million taxpayers from having to complete tax returns at a cost to the budget less than $5 billion per year.

Question 3: Who claims work related expense deductions?

In the most recently released Taxation Statistics the Commissioner states that the median claim for work related expense deductions for the 2021/22 year is $1,342 (up from $1,275 in the 2020/21 year). A standard deduction of $1,000 would therefore be applicable to less than half of individual taxpayers. The number of taxpayers covered by this standard deduction would decrease each year if the $1,000 threshold is not indexed (see Question 8).

The media release from 13 April announcing the standard deduction stated that only 39 per cent of taxpayers claim less than $1,000 in work related deductions. This media release also provided the following statistics:

- The average amount of annual tax relief for those who benefit will be $205.
- Australians earning between $45,001 and $135,000 could get a benefit of up to $320.
- Around 88 per cent of those that benefit will have a taxable income of less than $135,000 in 2026-27.

The data from the ATO Taxation Statistics provide a breakdown of how much the almost ten million taxpayers claimed in work related expenses in the 2021/22 year.

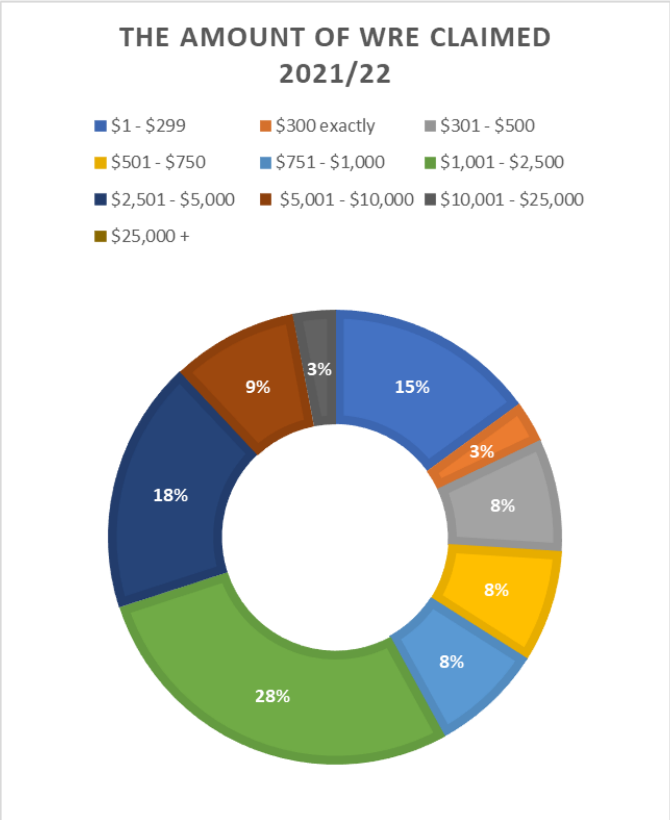

FIGURE 1: AMOUNT OF WRE CLAIMED BY TAXPAYERS
SOURCE: TAXATION STATISTICS 2021/21, WWW.ATO.GOV.AU
NOTE: $25,000+ IS AT 0.34% SO DOES NOT SHOW

Figure 1 shows that in the 2021/22 year, 15 per cent of taxpayers who claimed deductions for work related expenses claimed $299 or less and another 3 per cent claimed exactly $300.

These taxpayers fall within the $300 exception to the work-related expenses substantiation rules under section 900-3. This means that they only need to prove they spent the amount they claimed as a deduction rather than having full documentation.

Figure 1 shows there are another 24 per cent of taxpayers who claimed between $301 and $1,000 in work related expenses as deductions in the 2021/22 year who would have been relieved of any further substantiation requirements if a $1,000 standard deduction had been implemented.

It is expected that the implementation of a $1,000 standard deduction may affect the [tax gap that relates to work related expense deductions – the Commissioner's estimate of the amount of government revenue lost due to inappropriate deduction claims for work related expenses]. For the 2021/22 year, the tax gap for work related expenses was estimated to be at $3.6 billion (more than one third of the total tax gap for individuals not in business). The reasons behind this tax gap are shown in Figure 2:

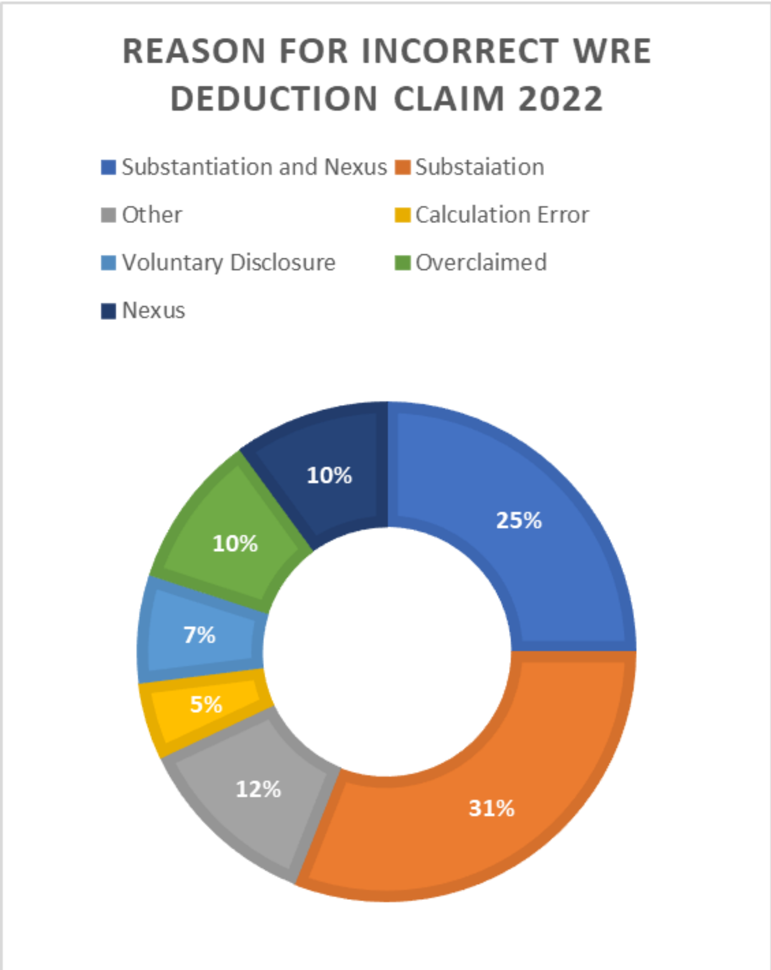

FIGURE 2: REASON FOR INCORRECT WRE CLAIM 2022
SOURCE: TAXATION STATISTICS 2021/21, WWW.ATO.GOV.AU

31 per cent of incorrect work-related deductions claims are due to the taxpayer not meeting the substantiation requirements of Division 900 and another 25 per cent of incorrect work-

related deductions are due to the taxpayer not meeting the substantiation requirements of Division 900 and the expenses not having a nexus to earning income.

A standard deduction will remove the substantiation requirements for around 40 per cent of taxpayers, and potentially greatly reducing the tax gap that relates to work related tax deductions.

Question 4: How do other countries use standard deductions?

Standard deductions or similar methods are used throughout the OECD, including in the US, Canada, Japan, France, Germany, Belgium, Poland, and Korea, but often in interesting ways. This table converts amounts to A$ using exchange rates as of 5 May 2025.

Country	Deduction
Belgium[1]	The standard expense deduction amounts to 30% of the gross earning, up to a ceiling of EUR 5,930 (A$10,393) plus some insurance expenses
Canada[2]	An employment tax credit of 15% of employment income (capped at C$215 - A$240). This is the reduction in tax (a tax credit) is more valuable to a taxpayer than an equivalent amount being provided as a deduction.
France[3]	Provides a standard allowance for professional expenses equal to 10% of taxable employment income (limited to EUR 13,522 on 2022 remuneration - A$23,700) OR claim actual
Germany[4]	1,000 Euro (A$1,753) standard deduction or actual costs
Japan[5]	An earned income deduction starting at JPY 550,000 (A$5,890) for those earning under JPY 1,625,000 (A$17,348) stepping progressively up to an earned income deduction JPY 1,950,000 (A$20,882) for those earning above JPY 8,500,000 (A$91,023).
Korea[6]	Standard deduction varies according to income. Maximum is 20,000,000 KRW

[1] https://taxsummaries.pwc.com/belgium/individual/deductions
[2] https://taxsummaries.pwc.com/canada/individual/other-tax-credits-and-incentive
[3] https://taxsummaries.pwc.com/france/individual/deductions
[4] https://germantaxes.de/work-related-expenses-for-employees/
[5] https://taxsummaries.pwc.com/japan/individual/deductions
[6] https://taxsummaries.pwc.com/republic-of-korea/individual/deductions

	(A$22,400). Deductions are allowed for superannuation, and credits are available for insurance, donations, and education.
Poland[7]	An individual doing independent work may claim various allowances, depending on the type of activities performed. In most typical situations, the standard deduction amounts to 20% of the revenue. For employees there is a standard deduction which is generally PLN 250 (A$102) per month. Where there is more than one employment relationship, the upper limit is PLN 4,500 (A$1,842).
United States[8]	The standard deduction for 2024 was: • USD $14,600 (A$22,514) for single or married filing separately • USD $29,200 (A$45,028) for married couples filing jointly or qualifying surviving spouse • USD $21,900 (A$33,771) for head of household Can claim separately for business use of car and home.

TABLE 1: EQUIVALENTS OF STANDARD DEDUCTIONS THROUGHOUT THE OECD
SOURCE: https://taxsummaries.pwc.com/ UNLESS SPECIFICALLY FOOTNOTED

The motivation behind these policies has been to ensure that simple employee returns can be mostly prefilled by the revenue authority and so lodged with minimal or no interaction with these taxpayers.

Other countries have gone down another path by completely removing the ability to claim work related expenses so that employee require their employers to incur or reimburse work related costs. An example of a country taking this option is New Zealand, which in the 1980s, funded substantial tax cuts (reducing their highest marginal rate from over 60 per cent to 30 per cent) by removing deductions for work related expenses. Currently, only about a third of New Zealand taxpayers lodge tax returns.

[7] https://taxsummaries.pwc.com/poland/individual/deductions
[8] https://www.irs.gov/credits-and-deductions-for-individuals

Question 5: Who won't the proposed standard deduction assist?

A $1,000 standard deduction will not assist the majority (61 per cent) of taxpayers as they currently claim more than $1,000 in work related expense deduction. Examples of taxpayers who will need to continue to ensure they have appropriate documentation in relation to their deductions include:

- Taxpayers who only derive investment income;
- Taxpayers who only derive business income. There are situations where a business owned by an individual (a sole trader) derives its income from the labour of that individual. There will need to be consideration as to whether the income in these situations will be "labour income" or "business income" to establish whether the individual can claim the proposed standard deduction;
- Taxpayers who only derive a combination of investment and business income;
- Taxpayers with substantial work-related expense deduction claims above $1,000, including those paying for self-education expenses;
- Taxpayers with substantial work-related travel expenses. For example, if you travel more than 1,140 kilometres a year for work and use the cents per kilometre method to claim deductions for car expenses, then you would have deductions more than $1,000. (88 cents/km for the 2024/25 year x 1,140 km = $1,003).

If your work expenses are only relating to working from home, then unless you have worked from home for more than 1,400 hours (37 weeks for 29 hours each week), you will be better off claiming the standard deduction than using the method available under Practical Compliance Guideline 2023/1.

Question 6: Will the standard deduction change taxpayer behaviour?

The proposed standard deduction may change the behaviour of taxpayers. Four types of taxpayers appear to be the most likely to respond to the proposed standard deduction.

First would be taxpayers who have no labour income and so are not eligible for the standard deduction. If these taxpayers could change their arrangements to receive some labour income, even possibly $1, then they may be able to elect to use the standard deduction. The owner of a business who only receives profit distributions may look to replace some of this profit with a salary to be eligible for the standard deduction.

The second group of taxpayers who may change their behaviour are taxpayers who claim just above $1,000 in work related deductions (Table 1 shows that 25% of taxpayers claim between $1,000 and $2,500). Both the convenience of not having to retain the required substantiation and the lack of risk of compliance activities by the ATO may encourage these taxpayers to forgo the additional deduction claims above $1,000 and claim the standard deduction.

The third group of taxpayers who may change their behaviour are those who previously have not had the appropriate substantiation, or not have actually incurred work related expenses, but have incorrectly claimed such expenses in their tax returns. While it is not possible to assess to what extent this may occur, it may be that being able to claim $1,000 without substantiation and without having to incur any deductible work-related expenses, might mean certain taxpayers will only claim the standard deduction, rather than make incorrect claims.

The fourth group of taxpayers who may change their behaviour are those who only have small work-related expenses claims who engaged tax agents only due to the concern of incorrectly calculating this small deduction. These taxpayers may now elect to use the standard deduction and not engage the tax agent.

Question 7: Will the current work-related substantiation rules change?

Currently there are a variety of provisions whose objective is to reduce the compliance burden on taxpayers.

It is possible that, in implementing the standard deduction, the government may look to make consequential changes to the work-related deduction substantiation rules in Division 900 now that there is an effective substantiation exemption through the standard deduction.

Under current law, reduced levels of substantiation apply for:

- Work expenses less than $300 (section 900-35);
- Laundry expenses less than $150 - this is in addition to the concession about less than $300 work related expenses (section 900-40);
- Reasonable travel and meal allowances (sections 900-55 to 900-60);
- Individual expenses under $10 (section 900-125);
- Car expenses which relate to business use of less than 5,000 kilometres by allowing the use of the cents per kilometre method (Subdivision 28-C); and
- Working from home expenses by allowing the use of a fixed deduction for each hour worked (Practical Compliance Guideline 2023/1).

For those taxpayers who will not be taking advantage of the standard deduction, the continuation of these compliance saving measures, apart from the concession for work expenses less than $300, will be important.

For those taxpayers who will be using the standard deduction, it will be important to determine whether expenses, such as:

- car expenses will be included in the standard deduction, or whether like in the United States a separate deduction can continue to be made; and
- Costs associated with reasonable allowances for travel will be included in the standard deduction or be made non-deductible and the allowance non-assessable as suggested in the Henry review.

Question 8: How to protect the standard deduction?

As a part of implementing a standard deduction, three other important issues to consider are:

Issue 1: Index the standard deduction and all substantiation thresholds

The $300 substantiation exemption in section 900-35 has halved in value since it was introduced. The $300 substantiation exemption in section 900-35 was rewritten into the ITAA97 in 1998. Since that time inflation has meant that, if the $300 amount was indexed to inflation (CPI), it would already be at over $600.

To make sure the underlying policy objectives of the $1,000 standard deduction is not lost due to the combination of inflation and the passage of time, the $1,000 threshold should be indexed.

A variety of indexation methods are available, such as the wage price index, the consumer price index or a combination of the two, such as that used for calculating HECS loans. It is likely that the consumer price index (CPI) would be chosen as the appropriate indexation factor as the threshold relates to expenses incurred by taxpayers.

But indexing can cause confusion if it results in the amount changing each year and the amount not being a nice easy to remember round number. Consideration could be given to only indexing the threshold amount (currently $1,100) in $100 increments. Such a precedent has been set in Subdivision 960-M (which allows specific threshold amounts to increase indexation to increase in easy to remember amounts such as $5,000 for superannuation).

This will mean that the $1,000 threshold will not rise until inflation would push the amount past $1,100 and when this occurs, the threshold will increase to $1,100. The next increase in the threshold would be to $1,200.

When indexing the $1,000 standard deduction, the government should also consider indexing all the thresholds in Division 900 that remain when the standard deduction is implemented (see Question 7 above).

Issue 2: Provide certainity to taxpayers at the time of purchase

The underlying problem with the current $300 substantiation exemption (and with the proposed $1,000 standard deduction) is that taxpayers are unaware if they need to obtain and retain written evidence of an expenses at the time of purchase. A taxpayer who purchases stationary in July for $20 does not know until the next 30 June if the total of their work-related expenses is above or below $300 (or $1,000) and so during the year when they incur the expense they cannot assess if they need to obtain and retain written evidence.

There is one substantiation concession for work related expenses that might allow a taxpayer to decide at the time of purchase if they need to obtain and retain written evidence. The small expense substantiation concession (section 900-125) states that if a work-related expense is $10 or less the taxpayer can make their own record of the expense rather than getting a document from the supplier. However, the total of these small expenses must be $200 or less in a year.

This section is rarely used as not many items are less than $10. It was low when added to the 1997 Act (in 1998) and is even lower today having remained unindexed for 27 years.

When the GST Act was introduced in 2000, the rules requiring a taxpayer to hold a valid tax invoice to claim input tax credits only applied to expenditure greater than $50 (GST exclusive). On 1 July 2007, this threshold increased by 50% to $75 (GST exclusive). If this amount had be indexed each year it would now be around $120.

Increasing the substantiation threshold for small work-related expenses from $10 to $75 (potentially $82.50 as employees do not claim input tax credits) and the $200 cap could be considered as a part of the implementation of the standard. Given the standard deduction is set at $1,000, it may be appropriate to cap the overall number of small work-related expense amounts at $1,000.

It may also be worth considering aligning the thresholds for small receipts between the GST and income tax systems.

Issue 3: The interaction with other provisions

There are certain interactions with other provisions that will need to be considered when implementing the proposed standard deduction.

It is unclear how the standard deductions rules will:

- Apply to taxpayer’s receiving certain allowances for cars, travel and meals
- Apply where the Personal Services Income rules have been applied.
- Interact with the fringe benefits tax system, given the use of the ‘otherwise deductible rule’.