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How much income tax do we really pay? An analysis of 2011–12 individual income tax data

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Executive summary

- Personal income tax is the largest component of tax revenue. Hence any conversation about tax reform should consider the personal income tax system.
- The individual tax system is designed to be progressive, with increasing marginal tax rates at higher income levels. This contrasts with indirect taxes which are generally flat or slightly regressive in their effect.
- This analysis uses 2011–12 tax return data on 12,736,030 tax filers to investigate the use of deductions and offsets across income levels. This data provides information at a detailed level of income grouping, including for those with incomes over $1 million in the income year.
- Wages and salaries formed the bulk of income for most taxpayers except at the lowest and highest income levels. For low income groups, pensions and allowances are also significant, while for very high income earners, income from investments is the major source. However, all income sources were recorded at all income levels, with some low income earners reporting income from partnerships and trusts and investments including rental housing, while a limited number of high income individuals reported income from pensions and allowances.
- The largest category of deduction recorded in tax return data related to rental deductions. Deductions were larger than income on average for rental properties across all income groups. The highest percentage losses were among those with incomes (net of their rental loss) between $55,001 and $80,000 with deductions exceeding income by more than 28%.
- In general, the value of deductions claimed increased with income. However, for some deductions related to specific forms of earnings, deductions as a proportion of these earnings declined as income increased.
- The low income tax offset is the largest value tax offset in the individual tax system, and, not surprisingly, low income groups were the main beneficiaries.
- The second largest value tax offset is the termination payment offset. This offset was of very little value to low and medium income groups, but was of significant value on average to high income earners. For those who claimed this offset and had an income lower than $150,000, it was worth less than $4,000 on average, whereas for those with incomes over $500,001, this offset was worth an average of over $45,000.
- Despite a greater average value of deductions and offsets to high income earners, overall the progressive nature of the Australian individual income tax system is not significantly reduced.

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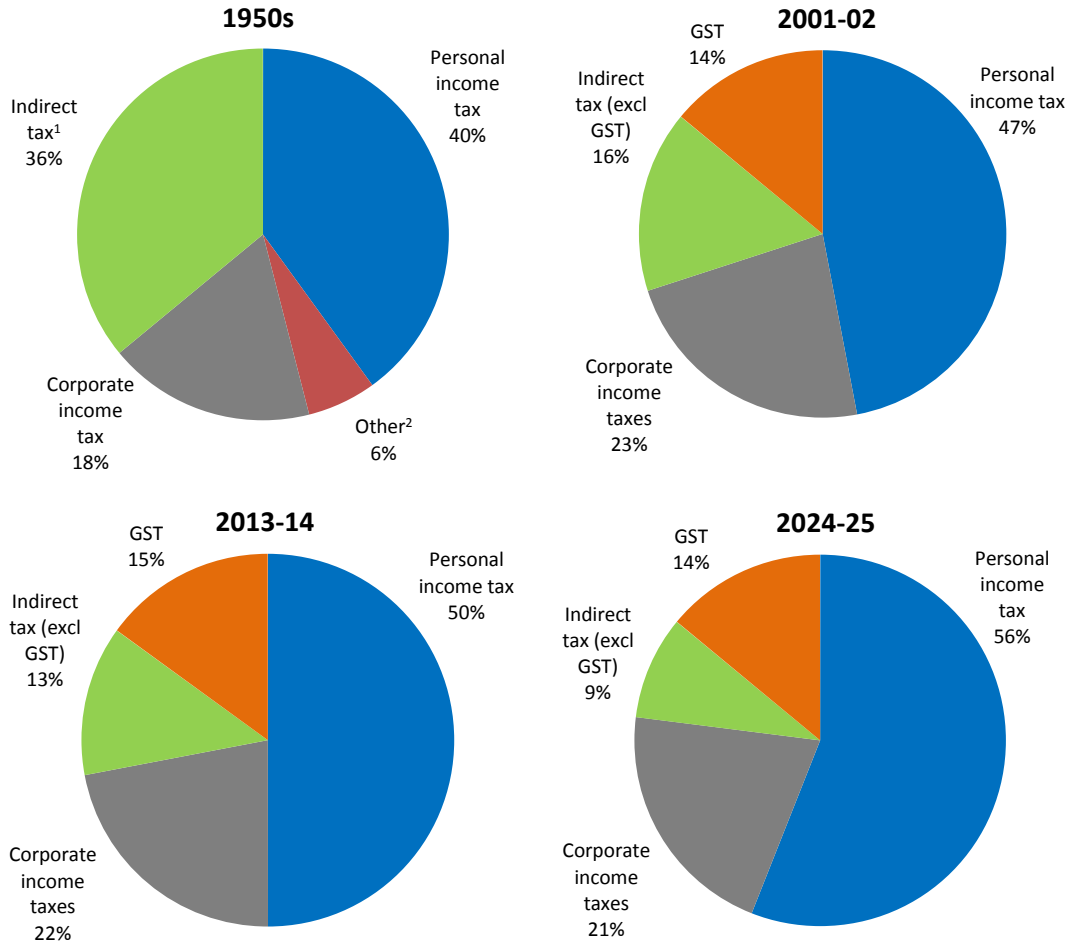
Introduction

In the context of ongoing budget deficits and limited success in reducing the expenditure side of the ledger, as well as the perceived pressures of an ageing population, the Government has declared that '[T]he time for a national conversation on tax reform is now.'[1] As such it has released a discussion paper to prompt community input, with the intention of releasing an options paper in mid to late 2015.[2]

Personal (individual) income tax has been, and is expected to remain, the largest component of Australian government tax revenue as shown in Figure 1 below. It also directly affects the majority of the adult population. Therefore it is reasonable to assume that any conversation about tax should consider this area. On this basis it is timely to analyse in more detail the tax that individuals pay, in particular to assess the scope for delivering the Government's objective of taxes that are 'lower, simpler, fairer'.[3]

Figure 1: composition of Australian taxes over time

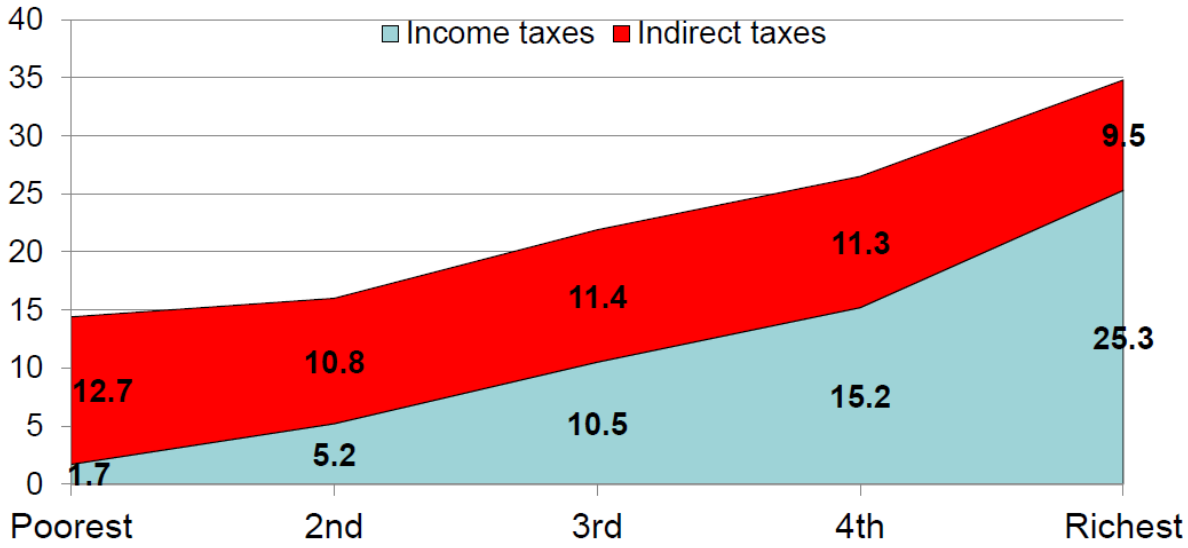


Source: Australian Government, *Re:think—tax discussion paper*[4]

In general, the Australian individual tax system is considered 'fair' because marginal tax rates are progressive, meaning high income earners pay a larger proportion of their income in tax than low income earners. This is in contrast to indirect taxes, such as the Goods and Services Tax (GST), which tend to be slightly regressive—that is, lower income earners pay a higher proportion of their income on these taxes than high income earners (see Figure 2 below).

1. Australian Government, *Re:think—tax discussion paper*, the Treasury, March 2015, p. 1, accessed 2 April 2015.
2. Australian Government 'Have your say', Re:think—better tax, Better Australia website, 2015, accessed 2 April 2015.
3. Australian Government, *Re:think—tax discussion paper*, op. cit., p. 2.
4. Ibid., p. 21. For notes to this figure, see the original.

Figure 2: direct and indirect taxes as a percentage of income by quintiles of equivalised disposable income, 2009–10



Source: M Stewart, *Durability and fiscal sustainability: Federation, health and reform of the tax system*[5]

However, this does not mean that all aspects of the individual tax system operate equitably. This paper uses Australian Taxation Office (ATO) data for 2011–12, which was the latest available at the time of writing, to provide some context to this aspect of the tax conversation.[6] In particular, it investigates the extent to which certain deductions and tax offsets in the individual tax system are used by tax payers across different income ranges, and the impact these have on potential tax revenue and the equity of this system. The paper does not analyse income sources outside the current individual tax system such as capital gains on the sale of the family home, most superannuation tax concessions and inheritances.

Australia's individual income tax system

Australians pay tax on an individual rather than household basis, and for individuals the income year runs from 1 July to 30 June.

Who lodges a tax return?

All residents whose total taxable income from all sources in an income year exceeds the tax-free threshold are generally required to submit a tax return. In addition, those with taxable incomes below the threshold are also required to submit a return in certain circumstances such as: when they have had tax withheld from their income; if they wish to claim a refund of dividend imputation credits; if they have carried out a business; if they have a tax loss brought forward or in the current year; or if they wish to claim the private health insurance rebate.[7]

Those under the age of 18 who are not married and have an income greater than $416 in the income year from sources other than employment or personal services are also required to submit a return.[8] This is because they are taxed at the highest marginal tax rate for unearned income above this level, as an attempt to discourage income-splitting by diverting income to children.[9]

5. M Stewart, *Durability and fiscal sustainability: Federation, health and reform of the tax system*, presentation to the Australian Healthcare and Hospitals Association Think Tank, 16 March 2015, p. 6, accessed 14 April 2015.
6. Taxation statistics for 2012–13 were released on 29 April 2015.
7. CCH, *2012 Australian master tax guide—tax year end version*, CCH Australia, 2012, section 2-000, accessed 14 April 2015.
8. Ibid.
9. Ibid, section 2-160.

Non-residents are required to submit a return if they earned an income from sources in Australia other than interest, dividends or royalty income subject to withholding tax.[10]

For the 2011–12 income tax year (the data used in this analysis) 12,736,030 people had lodged individual tax returns by October 2013, of whom 2,936,210 (some 23.1%) were non-taxable.[11]

What is income?

Income for tax purposes generally includes:

- wages and salaries
- allowances
- business receipts (including income from rental properties)
- realised capital gains
- interest, royalties and dividends
- partnership income
- government cash transfers and
- distributions from trusts.[12]

There are exceptions to these categories. For instance, payments to Defence Force Reserves, which are similar to salaries, are not taxable. Neither are a number of allowances, such as living-away-from-home allowance and several defence force allowances. Some government pensions and allowances are taxable, while others are not. For example, Newstart Allowance and the Age Pension are taxable, but Disability Support Pension and Parenting Payment are not. Money received through gifts, gambling winnings (unless the taxpayer is carrying on a business of betting), inheritances, academic scholarships and life insurance proceeds are not taxable.[13] Benefits from some superannuation sources are untaxed for those retirees aged over 60.

In addition, some benefits provided to employees are not considered income by the employee for tax purposes, but are taxed in the hands of the employer. However, some of these fringe benefits may be included as income for other purposes, such as calculating the Medicare levy surcharge, Higher Education Loan Program repayments and determining eligibility for some offsets. For example, superannuation contributions paid through salary sacrifice arrangements are included for these purposes.

How tax is calculated

Tax liability is calculated according to the following formula:[14]

	Total income
less	current year deductions
less	earlier year tax losses
apply	marginal tax rates
add	extra income tax (typically applies to those taxpayers with income averaging arrangements)
gives	gross tax
subtract	offsets
add	Medicare levy
add	Medicare levy surcharge (payable by high income earners who do not have private health insurance)
gives	net tax. [15]

10. Ibid., section 2-010. Withholding tax is a flat rate tax on income from these sources held by non-residents and represents the final tax liability for those payments. It is withheld from the payment by the payee and passed by them to the ATO. For further details, see the *2012 Australian master tax guide—tax year end version,* op. cit., section 22–000.
11. Australian Taxation Office (ATO*), Taxation Statistics 2011-12*, 'Individuals tables',*Table 5: Individuals – returns by tax status, 2007–08 to 2011–12 income years*, ATO website, accessed 13 April 2015.
12. Department of the Treasury, *Tax expenditures statement 2014*, January 2015, p. 130, accessed 2 April 2015.
13. For a more comprehensive listing of what forms of income are taxable and which are not, see *2012 Australian master tax guide—tax year end version,* op. cit., Section 10-005.
14. Adapted from ATO, '*Taxation statistics 2011–12*: about taxation statistics—definitions', ATO website, accessed 13 April 2015.
15. After net tax is calculated, credit is applied for tax already paid (such as tax withheld from salary, tax file number amounts withheld from gross interest and franking credits) to give the tax payable or refundable. Some offsets are also refundable if they would otherwise reduce net tax to less than zero.

As can be seen from the formula above, deductions reduce the income on which tax is calculated. They are generally related to the costs of earning income, such as work-related expenses, interest and dividend deductions, the costs of operating a business, and the costs of operating a rental property. In addition, the cost of managing tax affairs is deductable from income. There are also a small number of deductions that are designed to encourage particular behaviours, such as for gifts and donations, and personal contributions to superannuation.

Because they reduce the amount of income on which tax is calculated deductions are of greater benefit to those on high incomes. For example, a donation to charity of $100 by someone whose income is over $180,000 in the 2014-15 year results in them paying $49 less in tax and Medicare levy, and hence the effective reduction in disposable income is $51.[16] However, for an individual with an income of $20,000 (whose marginal tax rate including the Medicare levy is 21%) the same donation would result in a reduction in disposable income of $79, while for someone with an income less than $18,200 (the tax-free threshold) the full $100 comes from their disposable income because they would not have otherwise paid any tax on this amount.

Offsets directly reduce the amount of tax payable, and are provided to cover a diverse range of circumstances. Some, such as the low income tax offset, the senior Australians tax offset and the pensioner tax offset are designed to remove most low income individuals from paying any tax. Others provide subsidies to taxpayers in particular circumstances, such as those working in remote localities, or who have received termination payments, while there are several offsets relating to dependents who meet specific limited criteria. The medical expenses tax offset provides some recompense for taxpayers with high medical expenses in certain circumstances.

Offsets (otherwise known as rebates or tax credits) provide the same benefit across taxable incomes. This means someone on the highest marginal tax rate receives the same zone tax offset as someone on the lowest marginal tax rate living in the same location. However many offsets, including the zone offset, are not refundable, and hence are of no benefit to those who not liable to pay tax.

In some years a levy is applied in addition to the above calculation. For example, for the 2011–12 tax year a flood levy was imposed at the rate of 0.5% of income from $50,001 to $100,000, and then $250 plus 1.0% of income above $100,001. For 2014–15 a temporary budget repair levy of 2.0% applies to incomes over $180,000.

2011–12 tax rates

Australian individual tax rates are progressive, with higher marginal rates at higher levels of taxable income, and there is a tax-free threshold below which no tax is payable in most circumstances. The tax rates for the 2011–12 income year are set out in Table 1 below. These rates do not include the Medicare levy (which was 1.5% for 2011–12), the Medicare levy surcharge (payable by high income earners who do not have private health insurance) or the temporary flood levy.

Table 1: tax rates for the 2011–12 income year

Taxable income	Tax on this income
0 – $6,000	Nil
$6,001 – $37,000	15c for each $1 over $6,000
$37,001 – $80,000	$4,650 plus 30c for each $1 over $37,000
$80,001 – $180,000	$17,550 plus 37c for each $1 over $80,000
$180,001 and over	$54,550 plus 45c for each $1 over $180,000

Source: ATO, 'Individual income tax rates for prior years'[17]

However, the operation of a number of tax offsets meant that the effective tax free threshold for most taxpayers was considerably higher at $16,000.[18]

16. This assumes the income would otherwise be taxed at the marginal tax rate of 45c in the $1 over $180,000, plus the 2% temporary budget repair levy and the 2% Medicare levy, meaning a total of 49% tax.
17. ATO, 'Individual income tax rates for prior years', ATO website, accessed 29 May 2015.
18. Australian Government, *Re:think—tax discussion paper*, op. cit., p. 41.

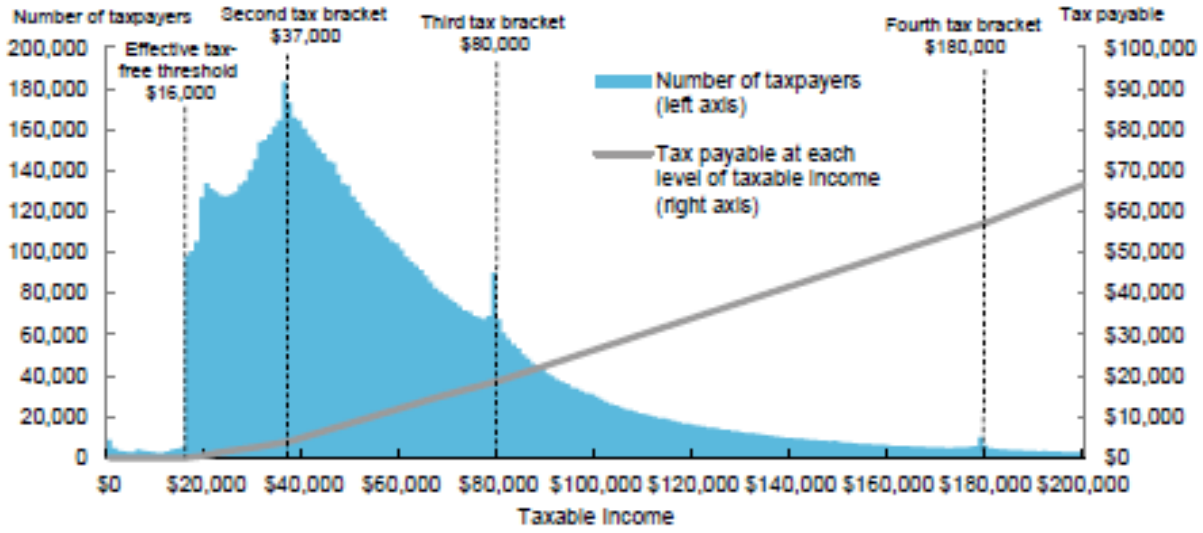
The 2011–12 individual income tax data

Unless otherwise stated, the analysis below is based on Table 9 of the ATO *Taxation statistics 2011-12: Individual tax*.[19] These statistics use the data recorded in income tax returns for the 2011–12 income year that had been received by October 2013. It is expected that this would cover most returns for that income year. The data available reflects the individual items listed in the *Tax return for individuals: 1 July 2011 to 30 June 2012,* and the *Tax return for individuals (supplementary section): 1 July 2011 to 30 June 2012.*[20] The data is based on the information filed in the tax return, and is not adjusted if the taxpayer is subsequently audited and details are amended.

This data is not publicly available at the unit record level, and hence it is not possible to analyse the tax behaviour of individuals, or to consider the tax arrangements of households (for example, to consider the extent of income-splitting). However, it does provide data grouped by income up to very high levels, with the highest income category being those with incomes over $1 million, which is not available elsewhere. For example, the 2011 Census data groups together all those with incomes of over $104,000, and due to the small proportion of people with incomes at these higher levels, data is generally not available from sample surveys as the sample sizes are insufficient for analysis. The distribution by taxable income of the data from these returns is shown in Figure 3 below.

The data used in this analysis is grouped according to both taxable income ranges and 'total' income ranges (as recorded on the tax return—that is, prior to applying specified deductions). For most taxpayers taxable income is slightly lower than 'total' income because they are able to claim some deductions. In some cases these reductions are very significant—for example, some 75 tax filers had a 'total' income of over $1 million in the 2011–12 year, but a taxable income of less than $6,000.[21] In addition, as can be seen in Figure 3, there are spikes in taxable income figures just below each of the marginal tax rate cutoffs. Therefore, in an attempt to better reflect the actual income distribution, the analysis below generally uses 'total' income groupings.

Figure 3: distribution of income tax payers by taxable income, 2011–12



Note: The chart shows the number of tax filers who paid net income tax in thousand dollar taxable income brackets up to $200,000. Tax payable is calculated by applying the individual income tax rate scale, LITO and the Medicare levy to taxable income.
Source: Treasury calculations using administrative data from 2011-12 tax returns for individuals.

Source: Australian Government, *Re:think—tax discussion paper*[22]

19. ATO, '*Taxation statistics 2011–12*: detailed tables, individual tax, Table 9: selected items, by total income and taxable income, 2011–12 income year', ATO website, accessed 13 April 2015.
20. ATO, 'Individual tax return instructions 2012', ATO website, accessed 15 April 2015.
21. For further analysis of the tax returns for this group see C Ey, 'The millionaires who pay no tax', FlagPost, Parliamentary Library weblog, 20 April 2015, accessed 21 April 2015.
22. Australian Government, *Re:think—tax discussion paper*, op. cit., p. 40.

The disadvantage of using this data is that it is only possible to analyse averages rather than look at individuals' patterns of behaviour. In particular, for very high income groups the number of tax payers in these categories is relatively small, and hence the average may be unduly affected by the data from one or two individuals. In addition, the number of tax filers in each category is rounded to the nearest five for privacy reasons, which may affect the averages for small numbers. However, average rates do provide at least some indication of the extent to which particular deductions or offsets benefit certain income groups.

It should also be noted that this analysis is based on the tax rules that applied in 2011–12. The tax regime is regularly amended, and in particular there were major changes in 2012–13 to the tax free threshold, which was increased from $6,000 to $18,200. Therefore some of the findings in this analysis may no longer apply.

Income

The 'total' income reported in the ATO tables may be considerably less than the actual income received for some tax filers. This is because in calculating the 'total' income reported from tax returns some deductions have already been applied. In particular, 'total' income includes net rent, which is gross rent minus interest, capital and other rental deductions. While the gross income from rent across all tax filers in 2011–12 was some $34.0 billion, the net rent represented a loss of some $7.9 billion, and it is this latter amount which is used in deriving the ATO 'total' income figure.[23] Similarly the ATO 'total' figure only includes net capital gains, which are generally the current year's capital gains minus carryover losses and then with a 50% discount applied. For 2011–12, total current year capital gains were $24.1 billion, while the net capital gain was only $9.2 billion.

Therefore, for the purposes of this analysis an additional concept of gross income is used to attempt to estimate the actual income received in an income year. It is calculated as the total income as provided in the tax return but without rent deductions, partnership and trust deductions, deferred non-commercial losses, tax losses from earlier income years and using current year capital gains instead of net capital gains.

Table 2 below shows the number of tax filers in each total income group, the proportion of filers in each group, and the comparative taxable, total and gross incomes for each group.

Table 2: number of tax filers in each income range, together with taxable, total and gross income, 2011–12

Total income range	Number of individuals	% by total income range	Taxable income $	ATO total income or loss $	Gross income $
Less than $0	129,770	1.02	42,788	-2,487,918,396	410,351,179
$0	47,510	0.37	3,362	0	-62,827,359
$1 to $6,000	741,680	5.82	1,807,515,688	1,926,326,963	2,758,567,667
$6,001 to $10,000	452,020	3.55	3,470,849,468	3,633,585,548	4,335,031,476
$10,001 to $15,000	706,560	5.55	8,589,078,580	8,898,272,103	9,919,272,482
$15,001 to $20,000	838,225	6.58	14,128,548,014	14,660,073,785	16,002,244,823
$20,001 to $25,000	781,285	6.13	16,777,088,987	17,553,324,345	18,917,996,801
$25,001 to $30,000	757,335	5.95	19,896,781,233	20,827,016,636	22,288,126,517
$30,001 to $37,000	1,093,980	8.59	35,129,429,804	36,711,896,629	39,081,124,959
$37,001 to $40,000	492,535	3.87	18,163,345,530	18,952,913,008	20,067,975,868
$40,001 to $45,000	765,275	6.01	31,075,923,812	32,492,877,200	34,320,717,864
$45,001 to $50,000	692,515	5.44	31,389,961,887	32,859,468,924	34,660,936,376

23. ATO, *Taxation Statistics 2011-12*,'Individuals tables', Table 13: Individuals – rental income and deductions, 2009–10 to 2011–12 income years, ATO website, accessed 13 April 2015.

Total income range	Number of individuals	% by total income range	Taxable income $	ATO total income or loss $	Gross income $
$50,001 to $55,000	615,840	4.84	30,805,440,277	32,293,968,495	34,091,840,222
$55,001 to $60,000	547,435	4.30	29,987,818,855	31,455,378,134	33,229,001,549
$60,001 to $70,000	927,260	7.28	57,196,770,069	60,078,087,772	63,552,724,941
$70,001 to $80,000	742,625	5.83	52,968,283,478	55,626,250,107	58,929,398,306
$80,001 to $90,000	591,670	4.65	47,547,889,317	50,063,579,368	53,006,791,273
$90,001 to $100,000	398,215	3.13	35,732,169,446	37,718,705,799	39,986,462,965
$100,001 to $150,000	885,485	6.95	100,135,326,294	105,819,623,043	112,621,088,496
$150,001 to $180,000	276,225	2.17	44,992,640,419	47,287,003,166	50,440,972,182
$180,001 to $250,000	101,475	0.80	21,242,105,895	22,479,731,777	24,003,504,278
$250,001 to $500,000	115,450	0.91	36,217,503,466	38,145,980,285	40,403,961,093
$500,001 to $1,000,000	26,355	0.21	16,801,238,949	17,635,997,109	18,475,318,514
$1,000,001 or more	9,200	0.07	18,171,489,554	19,248,454,304	20,958,751,651
Other	105	0.00	5,207,840	66,187,800	72,091,351
Total	12,736,030	100.00	672,232,453,012	703,946,783,904	752,471,425,474

Source: Parliamentary Library derived from ATO.

The analysis below largely excludes those with reported total incomes of $0 or less, as these tax filers do not require the use of deductions and offsets to reduce their tax liability, and hence their reporting of them may not accurately reflect their circumstances.

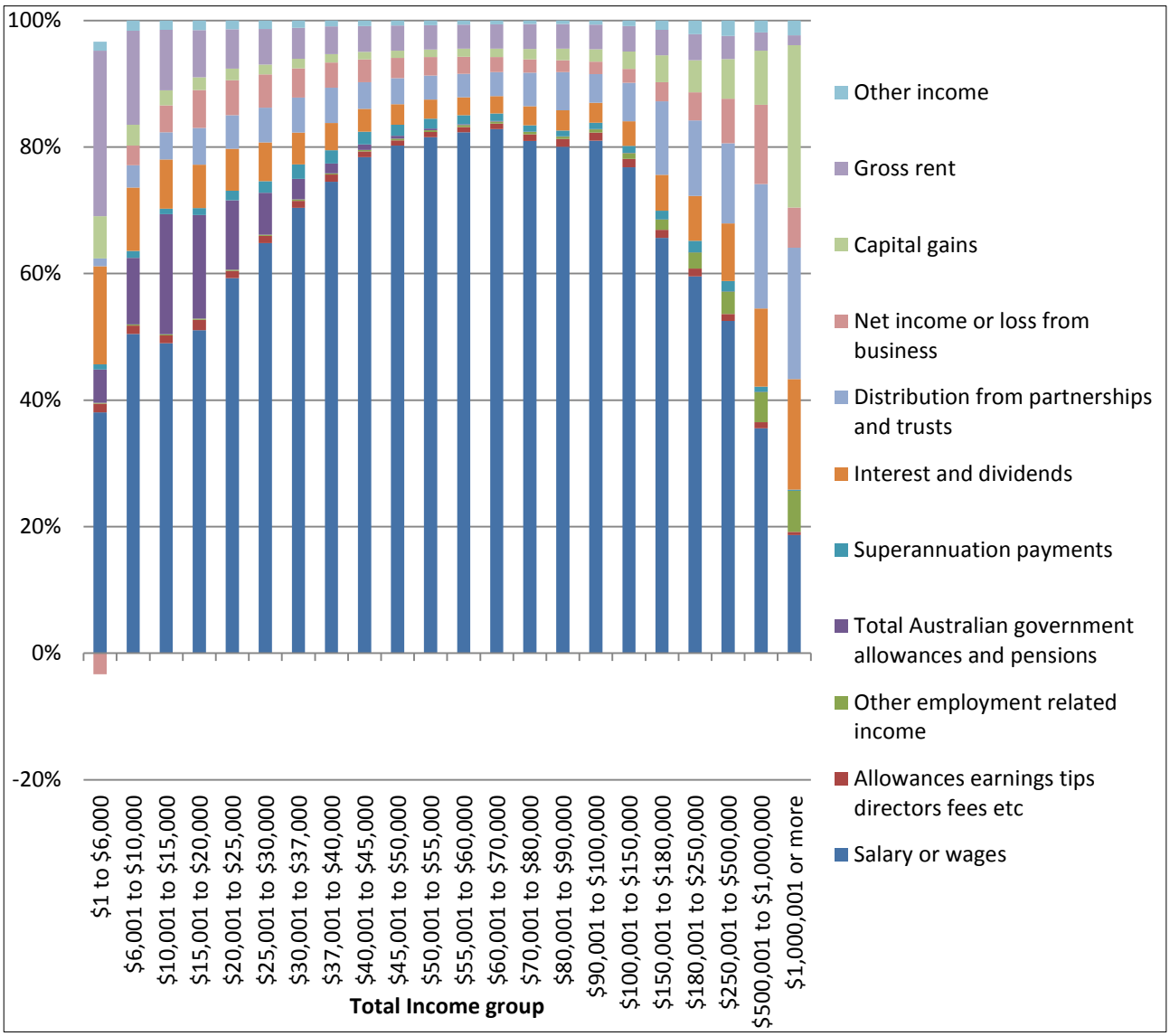
Figure 4 below shows the proportion of gross income from major income sources by the ATO 'total' income grouping. Salary and wages formed the bulk of income for most taxpayers except at the lower and upper ranges. For low income groups pensions and allowances were also a significant source of income, reflecting the targeted nature of most social security payments. However, gross rent and investment income also formed a significant proportion of income for this group on average, although it must be remembered that the income for many of these taxpayers was quite low. It is also interesting to note that while Australian Government pensions and allowances formed only a small proportion of the income of those with incomes over $100,000, they received a total of some $34.7 million in these payments. Note that Family Tax Benefit payments were not included in this amount, as they are not taxable.

To the extent that income-splitting was being used to reduce the tax liability of high income earners, it would be expected that this be through the use of partnerships and trusts, or business income. For example, the ATO has expressed concern about the use of partnerships by small law firms for income-splitting purposes.[24] However, while there were small peaks in the average level of income from partnerships and trusts for those with incomes in the range $30,001 to $37,000 and $80,001 to $90,000 (both around the thresholds for marginal tax increases) these are not significant. There was no noticeable peak around the average income from business at these income levels, rather there was a steady increase across the income ranges, which tends to suggest there was no particular tax advantage being sought.

24. K Towers, 'ATO sights on partners with guide to income-splitting rights and wrongs', *The Australian,* 5 September 2014, p. 31, accessed 14 April 2015.

For those with incomes over $1 million, wages and salaries formed less than 20% of income on average. Other major sources included capital gains, distributions from partnerships and trusts, and interest and dividend income.

Figure 4: income sources as a proportion of gross income by income group, 2011–12



Source: Parliamentary Library derived from ATO data.

Deductions

This analysis is limited to deductions listed in the individual tax return, that is, business-related items are not considered as they are not identified in this data source. Table 3 lists the major deductions that are identified in this data, and the total amount for each that was claimed in the 2011–12 income year.

Table 3: value of major deductions in individual income tax data, 2011–12

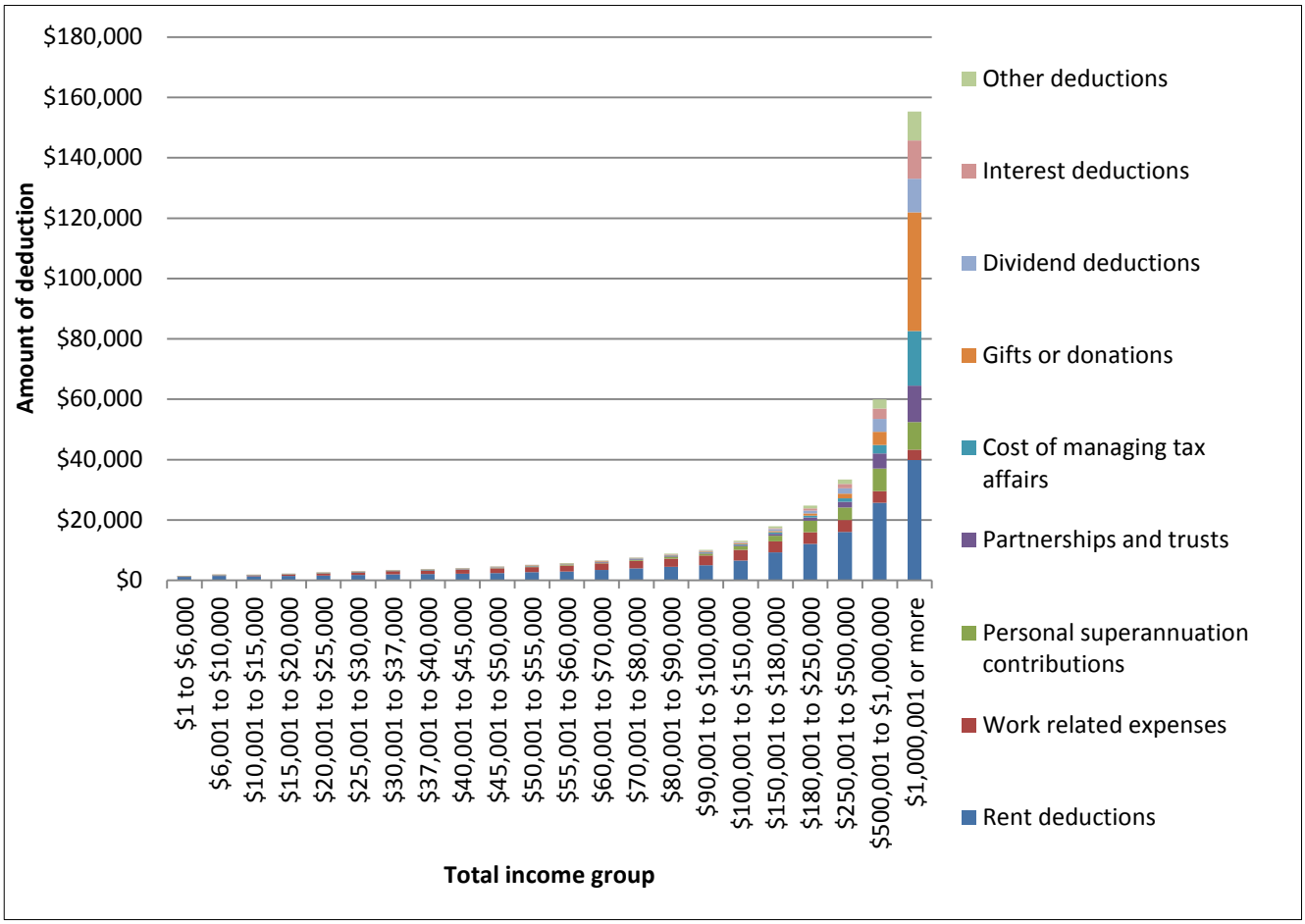
Item	$ billion
Rent deductions	
– Interest	24.2
– Capital works	2.2
– Other deductions	15.5
Total	41.9
Work related expenses	
– Car	7.8
– Travel	2.0
– Uniform/clothing	1.7
– Self education	1.1
– Other	6.8
Total	19.4
Personal superannuation contributions	4.4
Partnerships and trust deductions	2.4
Cost of managing tax affairs	2.3
Gifts and donations	2.2
Dividend deductions	1.4
Interest deductions	1.1

Source: ATO, Taxation statistics 2011–12.[25]

The value of these deductions claimed by tax filers increased substantially as total income increased. For example, the total average value of deductions claimed by those with incomes between $25,001 and $30,000 was just over $3,000, while for those with incomes over $1 million the value of these deductions was over $155,000 (see Figure 5 below).

25. ATO, '*Taxation statistics 2011–12*: detailed tables, individual tax, Table 9: selected items, by total income and taxable income, 2011–12 income year', ATO website, accessed 13 April 2015.

Figure 5: average deductions by income group, 2011–12



Source: Parliamentary Library derived from ATO.

While there was a general increase in the level of deductions claimed as income rose, there was considerable variation in the patterns across different deductions:

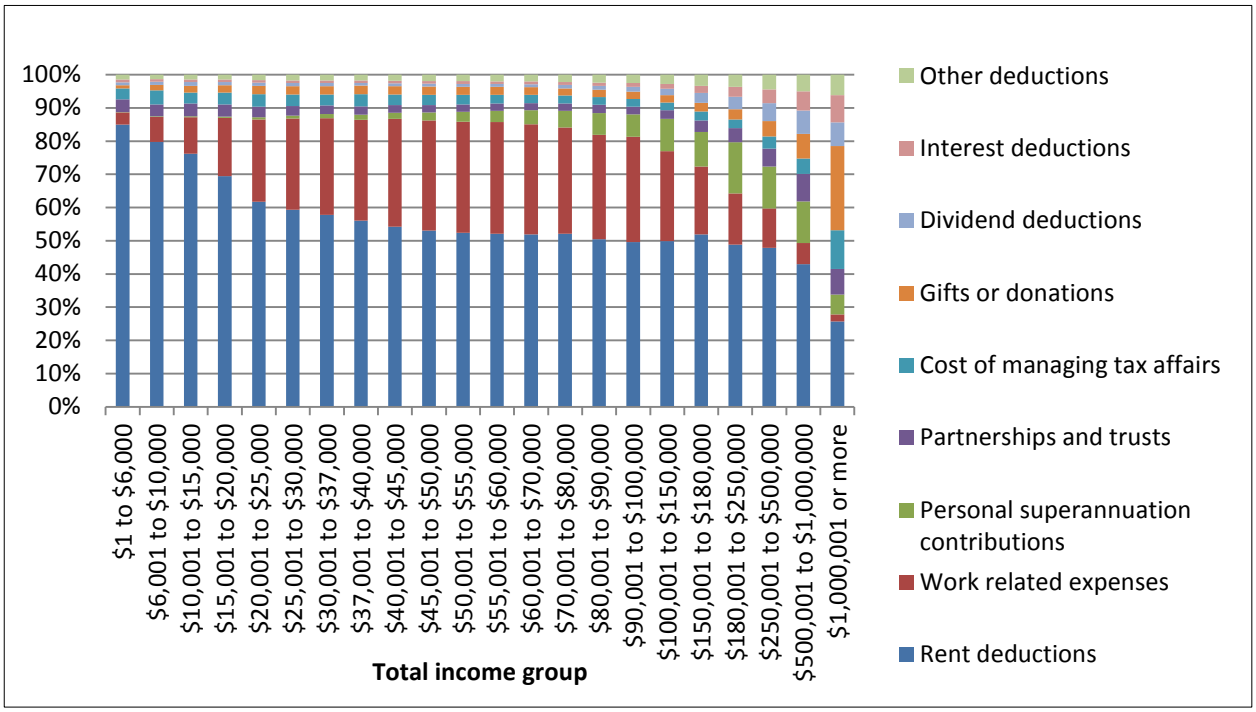
- rent deductions were the largest deductions claimed across the entire income range, on average ranging from around $1,500 for those with incomes between $6,001 and $25,000, rising steadily to $5,000 for those in the $90,001 to $100,000 range and then to nearly $40,000 for those with incomes over $1 million. However as a proportion of gross rent income, there was less difference, with all income ranges reporting a net loss on rental income (therefore reducing the tax payable on their income from other sources—that is, negatively geared). The highest proportional losses were experienced by those with incomes (net of the rental loss) between $55,001 and $80,000, where deductions exceeded rental income by more than 28%
- work related expenses were the second highest deduction on average for all income groups up to $180,000, but the variation in amounts was much lower, rising from just under $1,000 for those in the $30,001 to $37,000 range to a maximum of just under $4,000 for those in the $250,001 to $500,000 range. Within this category, there was very little difference across income levels of the average deductions for clothing or self-education
- personal superannuation contribution deductions increased on average with income, perhaps not surprisingly. Those with incomes less than $37,000 claimed on average less than $50, while an average of more than $9,000 was claimed by those with incomes over $1 million
- deductions relating to partnerships and trusts also increased steadily on average across the income ranges, largely reflecting increased earnings from these sources. As a proportion of income from these sources, deductions actually declined across the income range from over 18% for those with total incomes in the $6,001 to $10,000 range to less than 3% for those with incomes over $1 million
- the average deduction for the cost of managing tax affairs was between $50 and $100 for all those with incomes less than $25,000. It then increased steadily reaching just over $200 for those with incomes in the

range $80,001 to $90,000, before climbing to nearly $2,800 for those with incomes between $500,001 and $1 million. For those with incomes over $1 million the average jumped to more than $18,000. However this was largely driven by an average among those who claimed this deduction of some $1.4 million for some 40 tax filers with total incomes over $1 million who had taxable incomes less than $6,000. By contrast, those in the over $1 million income group claiming the deduction, who also had taxable incomes over $1 million (the major proportion), claimed an average of $10,000. This deduction includes the fees paid to tax advisers, the cost of travelling to receive that advice, and the cost of appeals relating to tax affairs. Possibly the average claim by those with a low taxable income reflects the high cost of some legal proceedings

- gifts and donations was the second highest average deduction (behind rental deductions) for those with incomes over $1 million, with an average deduction of just under $40,000. This was significantly higher than the level for those in the income range $500,001 to $1 million, who deducted on average just under $4,500. For incomes below this level the amount deducted declines steadily to less than $200 for those in the $80,001 to $90,000 level and then to under $50 for those with incomes less than $20,000
- like the deductions relating to partnerships and trusts, the increase in average dividend deductions across the income ranges is explained by the increasing income obtained through this source and as a proportion of the dividend income earned generally varies between 6% and 9%. As this deduction includes the interest on money borrowed to purchase shares and similar investments, this suggests that negative gearing of share purchases is not as frequently used as negative gearing of rental properties
- on the other hand, deductions related to earning interest income as a proportion of income received from interest increased substantially as total income rose, climbing from around 2% for those with incomes less than $40,000 to 9.3% for those with incomes between $100,001 to $150,000 and then to over 31% for those with incomes over $1 million. This deduction includes the interest on money borrowed to purchase income-producing investments. It is not clear what these investments might be, but the data suggests that this provision is more widely used by high income groups.

The proportion that each of these categories formed of total deductions by income group is shown in Figure 6 below. Deductions relating to rental properties formed at least half the total deductions claimed for all but the very highest income groups. These, together with work related deductions and personal superannuation contributions, formed nearly 90% of the deductions claimed by those with incomes less than $150,000. The very different pattern of deductions by those with incomes over $1 million is noticeable.

Figure 6: deductions by major category across income groups, 2011–12



Source: Parliamentary Library derived from ATO.

Like deductions, the ability to offset tax losses from earlier years reduces taxable income for claimants. This provision allows those with volatile incomes (such as from primary production or business) to effectively average their incomes across tax years. In 2011–12, some $1.7 billion of earlier year losses were claimed, with the average value per claimant rising with income from around $2,000 for those with total incomes less than $6,000 up to more than $900,000 for those with a total income over $1 million.

Offsets

Table 4 lists the major tax offsets in the 2011–12 individual tax system and their value.[26] By far the largest offset was the low income tax offset, which as noted above, had the effect of increasing the tax free threshold from $6,000 to $16,000 for most tax filers.

Table 4: major tax offsets, 2011–12

Item	$ million
Low income	8 131
Termination payment	1 102
Senior Australians	949
Medical expenses	600
Superannuation income stream	567
Mature age worker	458
Spouse	405
Pensioner	369
Zone or overseas forces	297
Private health insurance[(a)]	217

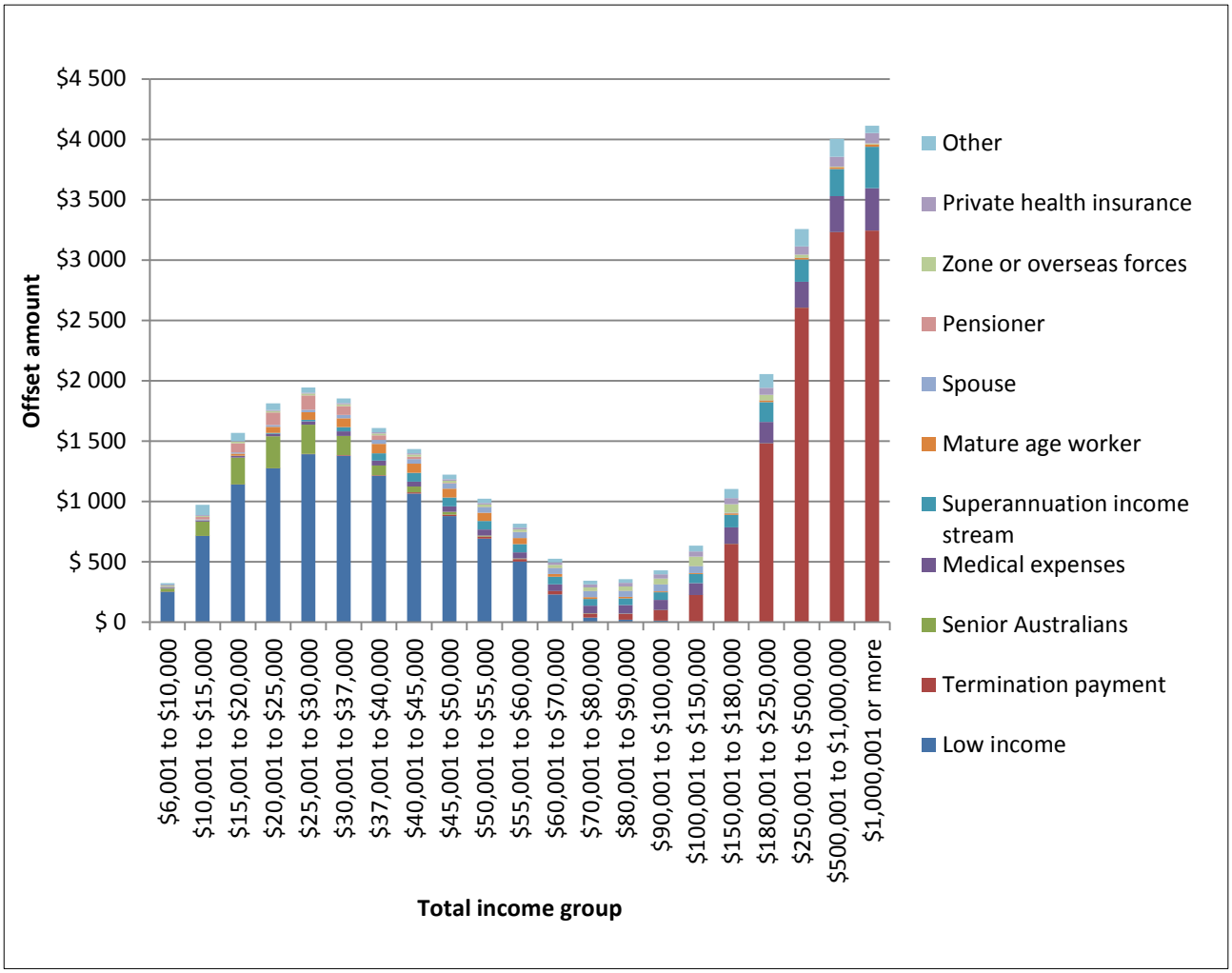
(a) The private health insurance tax offset figure only applies to those who claim this offset through the tax system, rather than through reduced premiums.

26. Franking credits on dividend income can also be considered an offset, but as they are included in 'income' and then treated as tax already paid, they are not included here.

Source: ATO, Taxation statistics 2011–12[27]

The distribution of these offsets by income groups is very different to the pattern for deductions, mainly because several of the offsets are targeted at low income earners (see Figure 7 below). Hence the low income tax offset was the dominant offset claimed by those with incomes less than $70,000, followed by the senior Australians and pensioner offsets.

Figure 7: average value of major tax offsets by income group



Source: Parliamentary Library derived from ATO.

In contrast, the termination payment offset was of limited average value to those with incomes under $100,000, but formed the major offset for incomes in the higher ranges, with a value of over $3,200 for those with incomes over $500,001. While these are average figures across all the tax filers in each total income range, and this offset was only claimed by a small proportion of tax filers (some 181,620), the pattern is similar for the amount claimed per claimant, with the value ranging from under $4,000 for those with total incomes less than $150,000 up to over $45,000 for those with incomes above $500,001. As noted in the tax discussion paper:

> The employment termination payment tax offset was originally intended to concessionally tax lump payments made on termination of employment, as a form of tax smoothing and retirement income support. Over time its purpose has become less certain. The introduction of the superannuation system has superseded the offset's retirement income objective, and the introduction of a maximum cap on the amount of offset a person can receive limits the extent to which it can actually smooth the effects of lumpy income.[28]

27. ATO, 'Taxation statistics 2011–12: detailed tables, individual tax, Table 9: selected items, by total income and taxable income, 2011–12 income year', ATO website, accessed 13 April 2015.
28. Australian Government, *Re:think* p. 53.

This suggests that there is limited justification for this offset, which costs $1.1 billion per year and is largely of value to those on very high incomes.

Perhaps not surprisingly, the average offsets for medical expenses, superannuation income streams and private health insurance generally increased at higher income levels, peaking at around $350, $340 and $90 respectively for incomes over $1 million.

For the remaining offsets, the distribution is varied. The mature age worker offset was of most value (between $50 and $80) for those with incomes between $20,001 and $60,000, while the average value of the spouse rebate peaked at $58 for those with incomes between $90,001 and $100,000, and the zone and overseas forces rebate was highest (at $78) for those with incomes between $100,001 and $150,000.

Implications for tax revenue and progressivity

As noted above, most deductions and some tax offsets are of more value to those with high incomes. So to what extent do these deductions and offsets reduce the progressive nature of Australian individual income tax rates?

Table 5 below shows what proportion net tax formed of taxable income and gross income (as defined in 'Income' above) for each of the income ranges. It can be seen that the application of deductions and offsets reduce the tax paid as a proportion of income across all income ranges. While this gap does increase as incomes rise the difference is not substantial.

Table 5: net tax as a percentage of taxable and gross income, 2011–12

Total income range from tax return	Net tax as % of taxable income	Net tax as % of gross income
$1 to $6 000	0.79	0.52
$6 001 to $10 000	0.47	0.37
$10 001 to $15 000	0.24	0.21
$15 001 to $20 000	0.74	0.65
$20 001 to $25 000	3.30	2.93
$25 001 to $30 000	5.41	4.83
$30 001 to $37 000	7.76	6.98
$37 001 to $40 000	9.94	9.00
$40 001 to $45 000	12.18	11.03
$45 001 to $50 000	14.63	13.25
$50 001 to $55 000	16.61	15.01
$55 001 to $60 000	18.27	16.49
$60 001 to $70 000	20.22	18.19
$70 001 to $80 000	22.00	19.78
$80 001 to $90 000	23.30	20.90
$90 001 to $100 000	24.73	22.10
$100 001 to $150 000	27.34	24.31
$150 001 to $180 000	30.42	27.14
$180 001 to $250 000	32.69	28.93
$250 001 to $500 000	36.65	32.85
$500 001 to $1 000 000	41.44	37.69
$1 000 001 or more	44.60	38.66

Source: Parliamentary Library derived from ATO.

While this underestimates the full impact of the range of deductions and offsets in the tax system, because the gross income figure used in this analysis incorporates some deductions, it is likely that even if these other deductions were removed the tax system would still operate strongly progressively.

However, it should also be noted that while differences are small in the proportion that net tax forms of taxable and gross incomes, at the higher income levels a small difference in tax rate translates to significant tax revenue.

For example, if the percentage of tax paid as a proportion of taxable income was applied to gross income, those with incomes over $1 million would have paid an additional $1.2 billion in tax for 2011–12.

Of course it needs to be remembered that removing or capping deductions and offsets may not result in a corresponding increase in revenue, as tax payers (and their advisors) respond to incentives in the system. In addition, removal of a tax concession in one area may have consequences elsewhere. For example, if negative gearing of rental properties (that is, claiming more in deductions than is earned in income) was removed, the additional costs could instead be offset against the capital gain realised when the property was sold, hence reducing future capital gains tax revenue.

Conclusion

This paper has attempted to provide some context to the 'national conversation' about individual income tax by providing details of the value of the major deductions and offsets in the individual tax system to tax payers across the income range. As such is does not address other tax concessions available to individuals such as the exemption of the family home from capital gains tax considerations, or most of the concessions relating to superannuation.

While there are clearly some deductions that are of much more value to those with high incomes, in many cases this reflects their higher income in the relevant area and the increased complexity of their tax affairs. Rental deductions are the largest deduction on average across all income ranges, with deductions being greater than the income received in aggregate for all income groups.

Tax offsets in total are more targeted at those on low incomes, in many cases removing them from paying any tax. However, the termination payment offset is second only to low income tax offset in total value, and is of most benefit to high income individuals.

Overall, these deductions and offsets reduce the proportion of gross income paid in tax by those on high incomes more than by those on low incomes. This is not sufficient to significantly distort the progressive nature of Australia's individual tax system, but does have considerable revenue implications.