

Work related deductions – improving policy and compliance

This paper considers ideas on how to improve the policy and taxpayer compliance in relation to work related deductions.

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Work related deductions “tax gap”

According to the ATO, the overall net tax gap¹ (The tax gap is an estimate of the difference between the amount of tax the ATO collected and what the ATO would have collected if every taxpayer was fully compliant with tax law) for the Australian tax and superannuation system was \$33.4 billion for 2019–20.

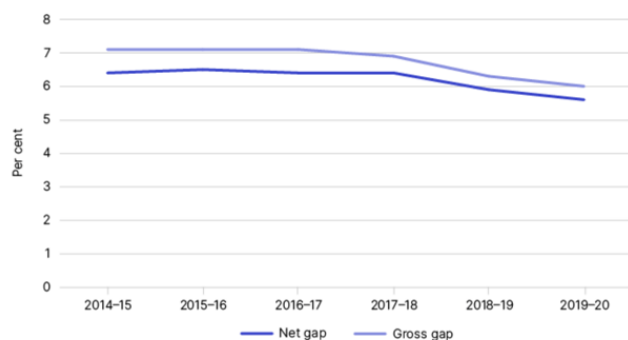
Individuals not in business (generally employees) make up 27% of this – around \$9 billion for 2019–20.

Also according to the ATO, 5.6% of the tax that should be paid by employees is not collected from these individuals.

This has remained reasonably stable, although dropping recently.

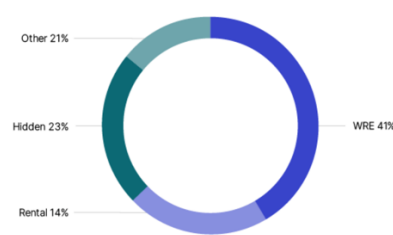
Element	2014–15	2015–16	2016–17	2017–18	2018–19	2019–20
Population (m)	10.6	10.8	11.1	11.3	11.4	11.6
Gross gap (\$m)	8,980	9,539	9,880	10,366	9,611	9,673
Amendments (\$m)	809	751	895	711	575	643
Net gap (\$m)	8,171	8,788	8,984	9,655	9,036	9,030
Tax paid (\$m)	119,184	126,095	130,426	140,849	144,360	151,498
Theoretical liability (\$m)	127,355	134,883	139,411	150,504	153,396	160,528
Gross gap (%)	7.1	7.1	7.1	6.9	6.3	6.0
Net gap (%)	6.4	6.5	6.4	6.4	5.9	5.6

From ATO.gov.au



From ATO.gov.au

According to the ATO, incorrect claims for work related deductions create a net gap estimate is \$3.7 billion, or 41% of all of the unpaid tax in this individuals not in business sector.



From ATO.gov.au

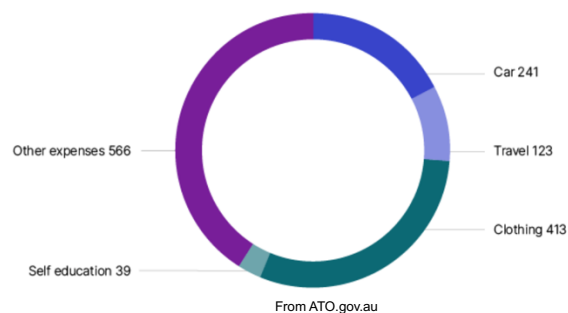
The ATO also states that it is just as likely that a mistake on work related deductions occurs in an agent-prepared return or self-prepared return.

¹ It should be noted that the Australian National Audit Office (ANAO) reviewed this tax gap calculation in April 2023 in a report titled “Identifying and Reducing the Tax Gap for Individuals Not in Business”, and supported the methodology used to calculate it. It is done by blind sampling and reviewing of taxpayers, and extrapolating those findings.

The Commissioner has indicated what the common reasons for adjustments in the random enquiry program were. They included:

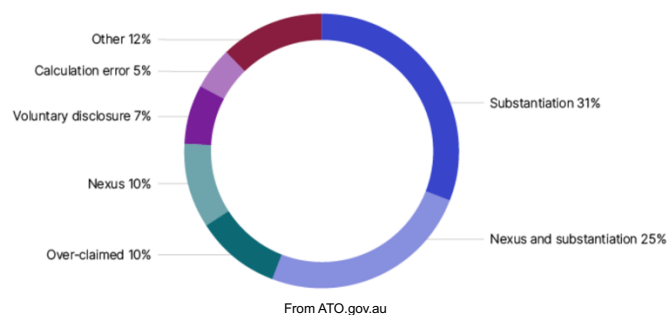
- claims for 'standard' deductions where exceptions to substantiation provisions exist, for example claiming \$300 for work related expenses without spending the money;
- no link between the expense and taxpayer earning their income;
- incorrect apportionment of private use vs work-related use – claiming expenses that aren't apportioned for personal use such as 100% of mobile phone expenses;
- claims that appeared legitimate, but could not be substantiated because there are no receipts, logbook or diary entries;
- claims for expenses that were actually paid for or reimbursed by the employer.

These work related expenses mistakes were broken down by the Commissioner as follows:



Based on the number of mistakes, it appears clothing claims are the most often incorrect claim. The Commissioner has also indicated that the highest rate of adjustments related to incorrect claims for home office, mobile phone and internet followed by claims for clothing and cars. This would mean much of the “other expenses” relate to home office, mobile phone and internet.

The reason for the mistakes were broken down as follows:



56% of the mistaken claims for work related deductions related, at least in part, to substantiation. 35% of the mistaken claims for work related deductions related, at least in part, to not being connected to income producing activities.

Summary of the work related deduction tax gap

1. Incorrect claiming of work related deductions by individuals not in business reduces Government revenue by \$3.7 billion a year, making up 11% of all lost tax revenues (all tax gaps);
2. Incorrect claiming of work related deductions by individuals not in business is the error making the largest loss of revenue in the individual not in business (generally employees) sector (41% of all loss of revenue);
3. There is no statistical difference in the number and quantum of error whether returns are lodged by agents or not;
4. Substantiation is the most common error across all types of work related expenses, especially due to a misunderstanding of the small total of expenses exception in subsection 900-35(1) ITAA97;
5. The four types of work related expenses that are most often incorrectly claimed are:
 - a. Home office expenses
 - b. Mobile phone and internet
 - c. Clothing
 - d. Cars

Tax statistics

The amount claimed on each label on the individual income tax return can be found through the taxation statistics released by the Commissioner each year. Below are the most recent statistics:

Taxation statistics 2020–21 Individuals: Selected deductions, by deduction type, deduction claimed range and state/territory¹, 2020–21 income year²

Deduction label	Amount \$
b. Work related car expenses Total	7,501,497,840
c. Work related travel expenses Total	1,564,723,085
d. Work related clothing expenses Total	1,777,632,352
e. Work related self-education expenses Total	1,200,888,031
f. Other work related expenses Total	10,892,585,916

MyTax and the Individual Tax Return

MyTax, third party software and the Individual Income Tax Return are the forms/methods through which these work related deductions are claimed.

While the Individual Income Tax Return only asks for the amounts divided into 5 categories, MyTax provides some guidance, and even for self-education expenses, requires a checklist to be completed.

Work-related car expenses ⓘ

Add

Description

Amount

\$0.00

❗ If you choose the **cents per kilometre method**, the set rate per work-related kilometre calculates your deduction for all of your car expenses. If you use this method, don't claim a deduction for decline in value, registration, insurance, maintenance, repairs and fuel costs separately for the same car.

Visit [work-related car expenses](#) ⓘ to learn more about the calculation methods, what you can and can't claim at this section and records you need to keep.

Your description (e.g. registration/make/model)

Calculation method *

Cents per kilometre

Work-related kilometres travelled *

Work-related travel expenses ⓘ

Add

Description

Amount

\$0.00

❗ If you travel for work overnight and you are claiming **accommodation, meal and incidental expenses**, you must claim the actual amount you incurred.

If you receive an allowance and your claim is less than the Commissioner's reasonable allowances amount you may not need to keep receipts. However, you must be able to explain your claim and show you spent the amounts.

Visit [work-related travel expenses](#) ⓘ to learn more about what you can and can't claim at this section and records you need to keep.

Your description

Amount

\$

Work-related clothing, laundry and dry-cleaning expenses ⓘ

Add

Description

Amount

\$0.00

❗ You can't claim the cost of buying, hiring, repairing or cleaning clothes you bought to wear for work that are not specific to your occupation, such as black trousers and a white shirt, or a suit, even if your employer says this is compulsory. These items are conventional, not usually a specific type and not sufficiently distinctive or unique to your employer.

Visit [work-related clothing, laundry and dry-cleaning expenses](#) ⓘ to learn more about what is conventional clothing, what you can and can't claim at this section and records you need to keep.

- Select -

Compulsory work uniform

✓ Non-compulsory work uniform

Occupation-specific clothing

Protective clothing

\$

Other work-related expenses ⓘ

Add

Description

Amount

\$0.00

Make any [working from home](#) ⓘ claims in this section. Select Add.

❗ If you are claiming for a **tool, equipment or other asset** that cost more than \$300, or is part of a set that together cost more than \$300, you must claim a deduction for the cost over the life of the item (that is, decline in value).

Use the [depreciation and capital allowances tool](#) to calculate the decline in value of an item.

❗ Only claim for the **work-related portion** of your expenses.

Visit [Other work-related expenses](#) ⓘ to learn more about what you can and can't claim at this section and records you need to keep.

Your description

Amount

\$

Work-related self-education expenses ⓘ

Add

Description

Amount

\$0.00

❗ You can't claim a deduction for self-education and study expenses that:

- > only relates in a general way to your current employment or profession
- > enables you to get new employment or change employment – such as moving from employment as a shop assistant to employment as an accountant.

If you are eligible, select the self-education type below that best describes your reason for incurring self-education expenses.

Self-education type

At the time you incurred the expense:

☐ The self-education maintained or improved a skill or specific knowledge required for your work activities as an employee.

☐ You could show that the self-education was leading to, or was likely to lead to, increased income from your work activities as an employee.

❗ You can't claim a deduction for self-education for:

- > tuition fees paid by someone else, including your employer, or for which you were reimbursed
- > repayments of study and training support loans, such as Higher Education Loan Program (HELP)

Visit [Work-related self-education expenses](#) to learn more about what you can and can't claim at this section and records you need to keep.

Note, a law change has removed the \$250 reduction previously applied for work-related self-education expenses. This change applied from the 2022-23 income year.

Deductions

D1	Work-related car expenses	A	\$							CLAIM
D2	Work-related travel expenses	B	\$							TYPE
D3	Work-related clothing, laundry and dry cleaning expenses	C	\$							CLAIM
D4	Work-related self-education expenses	D	\$							TYPE
D5	Other work-related expenses	E	\$							CLAIM

➤ You must read the deductions section in the instructions if you are claiming deductions for expenses that relate to your work as an employee at items D1–D6.

Proposals to minimise the work related deduction tax gap

From the above analysis, it appears there are five main areas to focus on to look to reduce the tax gap for individuals not in business by policy changes (rather than ATO compliance activities). They are:

1. Substantiation rules, especially the “small total of expenses” exception;
2. Phone and internet deductions;
3. Clothing deductions; and
4. Working from home deductions.

For each of these categories we should consider ideas that will discourage incorrect claims for deductions.

Substantiation ideas

Idea 1 – Click “I have substantiation” or “I have a log showing business and private use” when lodging a return

This simple idea is to have a substantiation declaration in an individual tax return where the employee must tick each one of a series of declarations based on the deduction they have claimed. Each declaration should also say that the Commissioner may ask for this substantiation so it must be retained.

Example of these declarations that should be required to be clicked by employees claiming work related deductions include:

- I have an actual written or digital record of the hours I worked at home (that I can provide to the Commissioner if asked to do so) and I am not making an estimate of the hours
- I have claimed the \$300 small expenses deduction but I have a list of the \$300 of expenses that I incurred (that I can provide to the Commissioner if asked to do so)
- If I have claimed more than \$50 for phone and internet deductions for the year, I have not estimated my work related use but have undertaken an analysis of actual phone usage for the year and have kept this analysis (that I can provide to the Commissioner if asked to do so)

A tax agent lodging the return for a client should be required to declare that they have informed the employee of the specific substantiation requirements for each work related deduction that is being claimed by their client. For example (using the three examples above), the tax agent should declare:

- I have informed my client that they must have an actual written or digital record of the hours they worked at home (that they can provide to the Commissioner if asked to do so) and that they cannot not make an estimate of the hours
- I have informed my client that if they have claimed the \$300 small expenses deduction they must have a list of the \$300 of expenses that they incurred (that they can provide to the Commissioner if asked to do so)
- If the taxpayer has claimed more than \$50 for phone and internet deductions for the year, I have informed my client they cannot estimate their work related use but they must undertake an analysis of actual phone usage for the year and have kept this analysis (that they can provide to the Commissioner if asked to do so)

Idea 2 – Change the exception for small total of expenses less than \$300 – Section 900-35

This is the most widely known section of the work related expenses substantiation rules. However, there are two problems associated with it.

The first is that it is misunderstood. Amongst taxpayers it is often seen as a standard deduction, which it is not, as it is only relief from the requirement to hold certain written evidence of already deductible expenditure.

The second problem, and its main regulatory burden, is that there is no way to know at the time of making a deductible work related expenditure whether this exemption will apply. If I was to purchase a train ticket between two places of work (deductible under section 25-100) on 1 July for \$20, I will not know until the following 30 June whether my total claim for work related expenses is \$300 or less and so I need to keep an invoice of the travel until this time. It is only after I have collected all the written

documentation during the year that I find out at the end of the year that I do not need the written documentation under this section.

This exception from the need to hold written documentation should offer a way to assess what documentation is required at the time of the expenditure.

There are two ways to do this, without needing to guess what future expenditure will be. These are:

- To replace this yearly exception amount with an exemption for each transaction. Such an exemption currently exists in 900-125 but this only applies to \$10 or less amounts, up to a total of \$200 and you are still required to make your own written documentation. Examples of this type of documentation exemption exists in other tax acts. In the GST Act, the rules regarding having to have valid tax invoices only apply to expenditure that is greater than \$75 (GST exclusive). The concerns about this idea will be expenses can be broken down into components for fall within this threshold. However, we have “set” rules in Division 40 regarding the instant assets for non-business entities where the asset is less that could be used to fix this problem (see subsection 40-80(2))
- Allowing an individual employee to not obtain written documentation for their first \$300 (or other appropriate amount) of expenditure. This would still require them to know what they have already spent in a year to assess if they need to keep/obtain documentation so is not as simple as the first option.

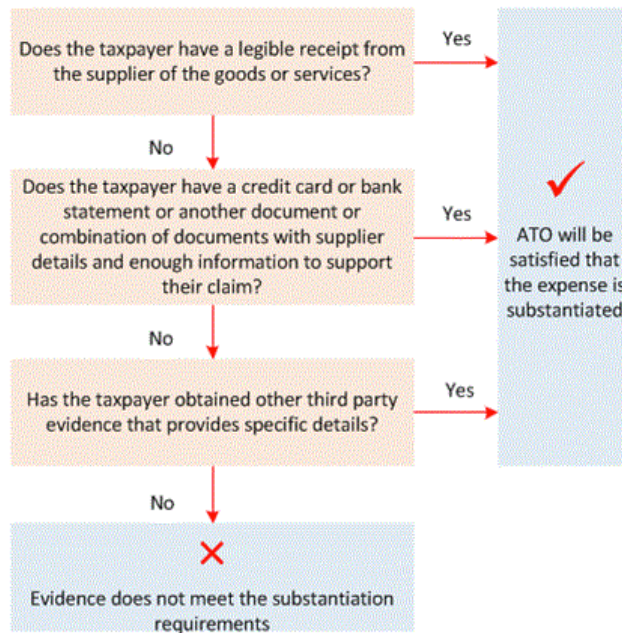
Idea 3 - Increase the ability to use of on-line bank statements and other records

In Practice Statement Law Administration PSLA 2005/7 (as updated to July 2015), the Commissioner states:

Where the above documents are insufficient, we accept the following documents (or combinations of documents) as acceptable evidence of expenses:

- *bank statements*
- *credit card statements*
- *BPAY reference numbers, combined with bank statements, or*
- *BPAY reference numbers, combined with tax invoices.*

The Practice Statement has the following diagram:



Subdivision 900-E states that “written evidence” must be “a document from the supplier of the goods or services the expense is for” (see subsection 900-115(2)). However, the second square in the document above shows that the Commissioner may accept merely a credit card or a bank statement. Further, subsection 900-115(3) states that if the written evidence from the supplier does not contain all the information required an individual can either use a “bank statement” or write the information themselves.

Finally, under section 900-125, if an expense is \$10 or less, and you have a small total of small expenses (less than \$200), you can make a record of the expenses instead of getting a document from the supplier.

All this goes to show that in many cases, the law and the practice of the Commissioner is not to require documentation from the supplier, but rather is to allow the individual to substantiate their work related expense through bank statement, credit card statement, and even through their own documentation.

Given the rise of electronic commerce, we might be able to simplify the written documentation needed to be obtained/retained so that the banking records and individual written documentation is appropriate substantiation in some/many/all cases.

Assuming the \$300 annual amount for not needing written documentation is replaced with a single transactional amount, then this would apply to amounts above that single transactional amount. The substantiation rules for these work related expenses above the small transaction threshold would be:

If the employee records certain information (date, amount, description and purpose) they do not require any additional third party supplier documentation, if and only if, the date and amount is evidenced in a bank or credit card statement as a single item on that statement.

The bank or credit card statement and the employee generate documentation must be retained for the retention period, including access to on-line statements or print outs of the statements.

If the amount is greater than the threshold and does not appear as a single line on a bank or credit card statement (a combined acquisition or paid by cash/barter...), the current rules apply and the individual must get supplier documentation.

Risks are that the bank statement hides the underlying transaction, especially if there are both deductible and non deductible parts. But in many cases the Commissioner is already accepting this risk (see PSLA 2005/7) and it brings the benefit of remove the ability to create invoices as the expenditure is linked back to the individual's bank account.

Idea 4 – Provide greater clarity on what is required

If ideas 2 & 3 were implemented, the substantiation rules would be simple for employees. For example, the rules would be:

Amount	Identifiable on bank/credit card statement (may be on-line) as a single item	Substantiation Required
Under small expense transactional threshold	NA	No written substantiation required, but amount must be incurred by employee and not reimbursed by employer (or other)
Above small expense transactional threshold	Yes	Employee documents date, amount, description and purpose of the expense and ensures the single item on the bank/credit card statement matches their documentation
	No	Documentation from the supplier that covers: <ul style="list-style-type: none"> • The name or business name of the supplier; • The amount of the expense; • The nature of the goods or services; • The day the expense was incurred; and • The day it is made out

Phone and Internet ideas

It must be acknowledged that the current method for claiming phone and internet deductions is ridiculous. For example, the Commissioner states the following on ato.gov.au:

“A reasonable basis to work out your work-related internet use could include... the amount of data you download for work as a percentage of the total data downloads by you and all other members of your household.”

There is no way to actually split data in such a way and practitioners know that the methodology offered by the Commissioner is unworkable. Compliance will always be less than ideal when the rules of compliance, like these, simply cannot be followed. The Commissioner needs to establish a practical way for individuals who are employees to reasonably apportion the phone and internet costs they have between work and private, especially given how common it is that employees use their private phone and data for work purposes.

Idea 5: Cents per day

To overcome the current problems in employees claiming use of phone and internet as a work related deduction, we could provide a cents per day deduction where every day the employee works and is not provided with a work mobile phone, they can claim a rate for phone and internet costs. This would be a very small amount, say \$0.25 a day, which would be \$60 for the year, only slightly more than the \$50 the Commissioner currently gives those as a deduction in a year who have no records.

Idea 6: practical apportionment methods

To overcome the current problems in employees claiming use of phone and internet as a work related deduction, we could allow the reasonable apportionment of both phone and data costs based on an analysis of phone calls alone. This would require the taxpayer to get a listing of calls, apportion them between business and private and use that percentage of the apportionment for all the costs (internet and phone). However, as less calls are being made on these phones, replaced with data calls or similar methods (MS Teams, Zoom...) this is not a long term solution

Idea 7: Phone and internet deduction declarations and labels

To improve compliance in relation to claimed for phone and internet work related deductions, there needs to be:

- A specific label for this expenses so it cannot be hidden within the other work related expenses label; and
- A substantiation declaration. This is where the taxpayer must declares that they have records showing how they have analysed their use of their phone and

data (not paid for or reimbursed by their employer) to calculate the amount they are claiming. If they do not click this declaration, they can instead click a declaration that states they have used their phone and data (not paid for or reimbursed by their employer) for business used but do not records analysing their use of their phone and data, and so they are given the standard deduction of \$50.

Clothing ideas

Idea 8: Repeal the 900-40 small laundry expense substantiation rule

Given the number of incorrect clothing deductions and the fact that many of these mistakes are as a result of no substantiation, we should consider removing the “small total of expenses” for laundry expenses of \$150 under 900-40. There is a misunderstanding that this creates a standard deduction and removing it would remove this misunderstanding. Also given the fact that these transactions are easy to track electronically, this substantiation exemption is no longer appropriate.

Idea 9: Cleaning and uniform declarations and labels

The label should have a substantiation declaration stating that the taxpayer has proof that they have incurred the amount in this label on cleaning specifically labelled uniforms (not general clothing) or protective gear.

Idea 10: Removing any deduction for purchasing uniforms or protective equipment for employees

We should also consider removing any deduction for purchasing uniforms or protective equipment for employees. We should require employers to provide (or reimburse) uniforms and protective gear for their employees, meaning so no deductions will arise for employees. This would not affect self-employed individuals from making these claims, as such a claim should still be available to individuals carrying on a business and claimed through the business supplement of the individual return.

Working from home ideas

Without actual data as to what precisely is the mistake, I would suggest the following are the main areas (or will be the main areas going forward) where incorrect claims for working from home deductions are made:

1. Claiming expenses that are only deductible if the home becomes a place of business (including ownership costs like interest, rent, taxes, insurance and rates)
2. Not having evidence of the number of hours the employee worked from home
3. Claiming all of the costs and not just the private portion

Idea 11: Insert labels, calculations and declarations for working from home deductions

To overcome the problem of incorrect claims for working from home deductions, we should consider having a specific label(s) for working from home work related deductions as we have for other categories as currently these expenses are currently wrapped up in the “other work related” label. Having a specific label would allow for the following.

- Like the car cents per km method, the MyTax form should ask for the number of hours worked if the individual is claiming the cents per hour rate and the form should apply the correct rate.
- In addition, like the self-education deduction area of MyTax where certain checklists must be completed, the employee should declare they are not estimating the hours but have an actual log of hours. If they do not declare that they have such an actual log of hours and are not estimating the hours in any way, then they cannot put the hours in and cannot use this method.
- There should be the option to use the actual method (rather than the cents per hour method). The labels should be divided between running costs (electricity, heating, stationary...) and occupancy costs (interest, rent, taxes, insurance and rates). However, to complete the occupancy cost label the taxpayer needs to declare that your home is a place of business (has a specific area only used for work and set up only for work that requires specific equipment for work above a normal office space)
- Alternatively, we could require any claims for occupancy costs (interest, rent, taxes, insurance and rates) to be done through the business supplement, such that the employee must show their home is a place of business.
- There should also be a label for depreciation of assets that are not covered by the cents per hour method.