



Individuals not in business income tax gap

Our current analysis and methodology for the individuals not in business income tax gap for 2021–22.

Published 1 November 2024

Latest estimates and trends



Compare the 2021–22 individuals not in business income tax gap to trends from previous years.

ATO action to reduce the gap



How we support our clients to meet their compliance obligations.

Methodology



What method we use to estimate the individuals not in business income tax gap.

Reliability



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Individuals not in business population

For 2021–22 we estimate a net gap of 6.1% or \$10.6 billion for individuals not in business. This means taxpayers paid around 94% of the total theoretical tax.

The population for this gap is defined as taxpayers who mainly receive salary and wages, with some other income, including:

- non-business income from the sharing economy
- 'passive income' which can include
 - dividends
 - interest
 - rental income.

To avoid double-counting, we exclude individuals that form part of the high wealth private groups. We cover these individuals separately.

This income tax gap is part of our overall tax performance program. Find out more about the concept of tax gaps and latest gaps available.

Overview of the latest estimate

Our current gap estimate is based on findings from our random enquiry program. We observe a downward trend from 2015–16 to 2018–19, followed by a steady estimate from 2018–19 to 2021–22.

In our random enquiry program, we found adjustments were made in both tax agent and self-prepared income tax returns, including:

- incorrect deduction claims for work-related or rental property expenses (or both)
- careless income tax return administration or preparation.

Lack of connection to income earned or substantiation for expenses were also significant issues.

Work-related expenses continue to be the single largest contributor to the tax gap before accounting for any corrective action from the ATO. They account for \$3.5 billion of the gross tax gap with errors relating to:

- incorrect claims of work-related expenses due to lack of connection to income producing activities
- poor record keeping
- not apportioning claims to account for private use.

Another key contributor was unreported income from hidden wages, which is part of the shadow economy. It contributed around \$3.2 billion in 2021–22 or 28% of the gross tax gap.

While the amounts over-claimed and under-reported by individual taxpayers may be small, collectively across a large population the overall revenue impact is significant.

Table 1: Income tax gap – individuals not in business, 2015–16 to 2021–22

Element	2015–16	2016–17	2017–18	2018–19
Population (m)	10.9	11.3	11.5	11.7
Gross gap (\$m)	10,269	10,633	11,137	10,700
Amendments (\$m)	804	980	801	692

Net gap (\$m)	9,466	9,653	10,336	10,008
Expected collections (\$m)	126,663	131,072	141,875	146,161
Theoretical liability (\$m)	136,129	140,725	152,210	156,169
Gross gap (%)	7.5	7.6	7.3	6.9
Net gap (%)	7.0	6.9	6.8	6.4

Figure 1 displays these trends as a percentage.

Figure 1: Gross and net tax gap percentage – individuals not in business, 2015–16 to 2021–22

 Line graph showing the gross and net gap in percentage terms, as outlined in Table 1.

Internationally, tax gaps are difficult to compare. This is due to:

- large variations in legal and tax systems
- market definitions
- availability of data
- methodologies used.

While this estimate is not directly comparable for these reasons, we use methodology that is used in similar tax regimes. The United Kingdom (UK) and United States of America (US) also use random enquiry programs. They are considered best practice when estimating from large and homogenous taxpayer populations.

The random enquiry program

In our random enquiry program, we randomly select and profile a sample of individual taxpayers who are not in business. People in the

sample identified as low risk are not inconvenienced by being investigated further.

We verify details where we can confirm the income tax return data by matching all material amounts with our third-party data. We refer to these taxpayers as the 'verified' portion of the sample. While we do not manually review these taxpayers, they remain part of our overall sample, contributing to our gap analysis.

The rest of the sample progress to a review, the random enquiry program, from which we gather information. We estimate the gap by using the incidence rate of adjustments and mean value of amendments resulting from non-compliance. Adjustments refer to changes we make to items on a tax return to correct errors identified in the review process.

This method provides insights into the:

- value of non-compliance
- proportion of the sample, and by extension the population, who are incorrectly reporting.

Findings from the random enquiry program

From 2013–14 to 2020–21, we undertook 4,125 random enquiry program reviews across a representative sample of the individuals not in business population.

The 2 years from 2019–20 to 2020–21 comprised 1,090 cases that informed our most recent year's estimate. Of these cases, 817 involved manual reviews, while 273 were verified using third-party data.

This sample was large enough to provide a suitable representation of the population. It's proportionally similar to, or greater than, other comparable countries' programs (for example, UK and US).

During the selection process, we stratified the population across all income bands to ensure the overall population was appropriately represented. Taxpayers in the tax-free threshold and low to very high incomes were represented as well as taxpayers with rental properties.

The sample includes taxpayers who lodged through various channels. The proportion of agent-prepared income tax returns in the random sample was representative of the total individuals not in business population.

We used a confidence interval to quantify the precision of the estimate. See [more about limitations](#). We're confident that the true value of the net gap in 2021–22 lies between 5.2% to 7.0%, or \$9.0 billion to \$12.2 billion.

In the 2019–20 to 2020–21 sample, the incidence of adjustment was 69%, with 81% of agent-prepared returns being adjusted. This compares with 53% of returns adjusted for people who self-prepared their tax return.

On average we made 2.6 item adjustments per income tax return. The median increase to taxpayers' taxable income (income less deductions) was \$955. While individually this amount may not be large, when aggregated across the whole population, the effect is significant.

There were:

- 65 cases where we decreased tax payable
- 69 cases where we adjusted solely in the taxpayer's favour.

Table 2: Overview of the 2019–20 to 2020–21 random enquiry programs for individuals not in business

Cases	Sample (no.)	Agent-prepared sample (no.)	Self-prepared sample (no.)	Agent-prepared sample (%)
Manually reviewed cases	817	535	282	65
Verified cases	273	87	186	32
Total finalised cases	1,090	622	468	57

Table 3: Comparison of the incidence of adjustment in all 2019–20 to 2020–21 random enquiry programs for individuals

Cases	Full sample (no.)	Agent-prepared sample (no.)	Self-prepared sample (no.)	Full sample (%)
Cases with adjustments	755	506	248	69
Cases with adjustments only in the taxpayer's favour	69	40	29	6.3

Note: The distribution of item adjustment values shows that 37% were \$150 or less and 27% were over \$1,000.

Table 4: Distribution of item adjustment rates and values in the 2019–20 to 2020–21 random enquiry programs (percentage) for individuals not in business

Range of adjustments	% of all adjustments	% of values adjusted
\$0–\$50	20	<1
\$51–\$150	17	1
\$151–\$300	14	2
\$301–\$500	10	2
\$501–\$1,000	13	6
More than \$1,000	27	88

Our analysis indicated that adjustment rates were broadly similar across tax agent practice and locations, although rates for smaller tax

agents were slightly higher.

Based on the analysis and findings of the random enquiry program and insight from our overall engagement program, we can highlight themes that contribute to the gap.

When we look at the most recent tax gap year estimate, we draw on the last 2 years of the sample only. Figure 2 shows a breakdown of the individuals not in business tax gap by the different drivers for the most recent years estimate.

Figure 2: Net tax gap breakdown by driver for individuals not in business, 2021–22

 Pie chart showing the breakdown of the net tax gap by the four main drivers: work-related expenses at 29%, rental expenses at 12%, hidden income at 32% and other at 26%.

What is driving the gap

Through our analysis, we found several main areas that contribute to the individuals not in business tax gap:

- [Work-related expenses](#)
- [Undeclared income](#)
- [Other findings and observations](#)

Work-related expenses

Work-related expenses are a key component of the individuals not in business income net tax gap. The work-related expenses net gap estimate is \$3.1 billion.

Each case can have multiple adjustments across the tax return. Of the 2,877 adjustments in identified cases, around 78% related to deduction items, including rental deductions. Around 46% or 1,319 were made at work-related expense items. Of those adjustments, 65% or 862 were made in agent-prepared returns.

Common reasons for adjustments in the random enquiry program include:

- 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 versus 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.

Work-related expenses adjustments and reasons

The following 2 pie charts display the number of adjustments to work-related expense items and the reasons for these adjustments.

The highest rate of adjustments was for 'other expenses'. In particular, incorrect claims for home office, mobile phone and internet. Claims for clothing and car were also frequently adjusted.

Figure 3: Number of adjustments to work-related expenses

 Pie chart showing a breakdown of the types of work-related expenses adjustments and number of times they occurred: car 217, travel 107, clothing 383, self-education 58 and other 554.

Figure 4: Reasons for work-related expense adjustments

 Donut graph showing the percentage breakdown of the reasons for adjustments made for work-related expenses: substantiation 34%, nexus and substantiation 28%, nexus 9%, over-claimed 7%, calculation error 8% and other reasons combined 14%.

Undeclared income

Omitted income, particularly cash wages and income from the sharing economy, also contributes to the tax gap.

Some people don't declare income and payments to avoid paying the right amount of tax or super. For example, some businesses may pay their employees 'cash-in-hand' and some taxpayers do not report all the cash income they earn.

We estimate the portion of the tax gap for 2021–22 attributable to unreported income was \$3.4 billion which includes hidden wages as

well as an estimate of income not reported from those operating outside of the system.

Identifying non-declared wages is difficult, even in a random enquiry program. We take a different approach to account for the impact of undeclared cash wages, an aspect of the **shadow economy**.

To help us estimate the undeclared wages in the individuals not in business population, we draw on 2 of our administrative gaps:

- pay as you go (PAYG) withholding gap
- super guarantee gap.

Our approach is incorporated in our shadow economy strategy.

Other findings and observations

Observations from our broader compliance activities reinforce findings from our random enquiry program. This further supports our understanding of what is driving the gap.

Deductions for rental property expenses are also a key contributor. The rental component of the net tax gap is estimated to be \$1.3 billion.

Our observations indicate that the most common reasons for adjustments to rental items on a tax return are:

- no or incorrect apportionment of the loan interest costs where the loan was re-financed for private purposes
- claiming costs as repair rather than a capital works deduction
- not apportioning expenses for private use of the property.

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ATO action to reduce the gap

How we support our clients to meet their compliance obligations.

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The key to an effective tax system is a high level of willing participation. This depends on how much the community values the system and has trust and confidence in us as administrators.

Individuals not in business are the largest community segment interacting with the tax and super system. Find out how they **contribute to our economy by paying tax voluntarily**. We discuss the challenges they face and how we're improving the system for people who want to do the right thing, while taking firm action with those who don't.

While most tax is paid voluntarily through the pay as you go (PAYG) withholding system, we're concerned with how many taxpayers over-claim deductions. We commonly see errors with:

- work-related expenses
- rental properties
- omission of income, particularly where wages are paid in cash.

A range of factors contribute to why some people misreport this information.

Based on the principle of willing participation, our strategies to reduce the gap include:

- improving and tailoring our public advice and guidance material, tools and services including advice on emerging risks like the sharing economy and cryptocurrencies
- increasing the quantity and quality of the data we collect
- adopting new ways of using data and technology to make lodging tax returns and substantiating deductions simpler, including streamlining reporting processes and pre-filling more information
- helping taxpayers and their tax agents report correctly, using 'nudge' messages and other correspondence to alert them where we see something unusual
- better understanding the circumstances of debt, doing what we can to prevent it and offering practical repayment options
- taking firmer action to address non-compliance among higher-risk taxpayers and tax agents, including additional audits in areas driving the tax gap

- pursuing penalties or prosecution or referring tax agents to the Tax Practitioners Board in the most serious of cases.

We also provide insights about opportunities for statutory law reform to improve the tax and super system to government through Treasury. We do this where we see the law is difficult for both taxpayers and us to apply and it may increase compliance costs. We also suggest where the law can be strengthened to allow us to deal with compliance risks more effectively.

We seek to administer the tax and super system fairly and consistently. We design our interactions with taxpayers and tax agents to be professional, contemporary and tailored to individual circumstances, making it easy to comply and hard not to.

While we focus on preventing non-compliance to reduce the gap, we will take action to protect the integrity of the system and ensure everyone – from individual taxpayers to the largest corporate groups – pays the right amount of tax.

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Methodology

What method we use to estimate the individuals not in business income tax gap.

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We use a 4 step bottom-up random enquiry approach to estimate the individuals not in business tax gap. Random sampling methods are highly credible and best practice. They are commonly used by international jurisdictions to estimate tax gaps for this type of population.

Step 1: Estimate unreported amounts

In each year we draw on a bundled sample of up to 3 years from the random enquiry program. The bundled sample is split into 2 key groups of those who are:

- progressed to manual review
- verified.

We combine the incidence rates and averages from these 2 groups. We then extrapolate to the population of individuals not in business to estimate the unreported tax liability.

We also estimate the impact of non-registration or non-lodgment of people outside the system. This estimate draws on comparisons of Australian Bureau of Statistics Census of Population and Housing data to income tax return data to estimate the number of non-lodging individuals who are not in business. We then estimate a dollar impact, drawing on the random sample data to determine the final amount. We discuss this further in [Limitations](#).

Step 2: Estimate for errors not detected

We apply an uplift to the unreported tax liability estimate to correct for errors not identified through the random enquiry program. Uplift factors are based on the midpoint of international ranges and account for non-detected amounts relating to:

- income misreporting
- deductions and other issues.

We also apply an uplift for non-detected amounts that relate to hidden wages, consistent with our wider program for wages. We discuss this further in [Limitations](#).

Step 3: Estimate for non-pursuable debt

We add in the value of non-pursuable debt. This is debt that the Commissioner of Taxation has assessed as:

- not legally recoverable
- uneconomical to pursue
- unable to be pursued due to another Act.

Debt trends show that it takes upwards of 5 years for non-pursuable amounts to crystallise or be considered finalised in any one financial year. As a result, we add a provisional amount of non-pursuable debt

to the actual amount recorded in the most recent 4 years, based on historical amounts.

Step 4: Consolidate the gap estimates

We calculate the gross gap by adding the unreported amounts from Steps 1 to 3. We calculate the net gap by subtracting the total amendment amount from the gross gap. Then we add the net gap to the expected collections to estimate the total theoretical liability. We derive both net and gross gap ratios by dividing the dollar amounts by the theoretical liability.

Summary of the estimation process

Table 5 provides a summary of each step of the estimation process and the results for each year.

Table 5: Summary of estimation process for individuals not

Step	Description	2015– 16	2016– 17	2017– 18	201 19
1.1	Estimate unreported amounts and extrapolate to population (m)	7,282	7,329	7,517	6,
1.2	Apply estimate for people outside the system (\$m)	134	230	207	
2.1	Apply estimate for non-detection (excluding hidden	229	365	537	.

	wages) (\$m)				
2.2	Apply estimate for hidden wages (\$m)	2,457	2,537	2,725	2,725
3	Estimate for non- pursuable debt (\$m)	167	172	151	151
4.1	Estimate the gross gap (by adding together the results of Steps 1 to 3) (\$m)	10,269	10,633	11,137	10,633
4.2	Subtract compliance outcomes and voluntary disclosures (\$m)	804	980	801	801
4.3	Net gap (\$m)	9,466	9,653	10,336	10,336
4.4	Add expected collections (\$m)	126,663	131,072	141,875	146,000
4.5	Theoretical liability (\$m)	136,129	140,725	152,210	156,000
4.6	Gross gap (%)	7.5	7.6	7.3	7.3
4.7	Net gap (%)	7.0	6.9	6.8	6.8

Find out more about our overall methodology, data sources and analysis used for estimating our tax gap estimates.

Limitations

Limitations with estimating this tax gap include:

- The 2021–22 estimate uses 2 of the 3 finalised random enquiry program sample years– this will be updated in future estimates.
- The precision of the estimate is limited by the sample size – to maintain suitable confidence intervals over time, we use an ongoing bundled sample.
- To reduce compliance costs for the taxpayer, we applied materiality thresholds at the data-driven review stage– if a case develops into a manual review, all items in the tax return are investigated regardless of value.
- There is no independent data source that can provide a credible or reliable macroeconomic-based estimate, unlike for indirect taxes.
- A limitation of the random enquiry program and similar programs in other jurisdictions is uncertainty around the impact of the non-detection error– the enquiries we undertake do not discover the full extent of non-compliance.

Accounting for non-detection in the gap

Not all errors are detected through the random enquiry program. We account for these by applying a non-detection uplift to the unreported tax liability estimate.

The 3 sources of non-detection for this tax gap relate to:

- income misreporting
- deductions and other issues
- hidden wages.

The unreported tax liability is divided into the above elements, with an appropriate non-detection factor then applied to each portion.

Table 6: Summary of the impact of non-detection on the in business income tax gap

Source of non-detection	2015–16	2016–17 (\$m)	2017–18 (\$m)	2018–19 (\$m)	2019–20 (\$m)
Income misreporting (excluding hidden wages)	189	336	345	308	219
Deductions and other issues	40	29	192	156	20
Hidden wages	2,457	2,537	2,725	2,946	3,071
Total non-detection	2,686	2,902	3,262	3,410	3,610

Accounting for the shadow economy

The shadow economy concerns economic activity not declared, which may be a result of attempts to avoid tax obligations. We account for the shadow economy in this tax gap by considering the impacts of:

- hidden wages
- people outside the system
- undisclosed business activity.

Table 7: Summary of the impact of the shadow economy on in business income tax gap (\$ million)

Element	2015–16	2016–17	2017–18	2018–19	2019–20
Hidden wages	2,457	2,537	2,725	2,946	3,071

People outside the system	134	230	207	184	14
Undisclosed business income	0	0	0	0	
Total shadow economy impact	2,591	2,767	2,932	3,130	3,21

Confidence in the random sample findings

A confidence interval quantifies the precision of the estimate from a random sample relative to the true value from the population.

A 95% confidence level is considered industry best practice in terms of statistical analysis. It is the most used level by researchers, including His Majesty's Revenue and Customs in the UK in its equivalent tax gap program.

Using a 95% confidence level means we are 95% confident that the true value of the net gap for 2021–22 lies in the confidence interval 5.2% to 7.0%, or \$9.0 billion to \$12.2 billion. The upper and lower bounds of the 95% confidence intervals follow. The gap estimates we make public reflect the mid-point of the lower and upper bound estimates.

Figure 5: 95% confidence interval – upper and lower bound estimates – individuals not in business income tax gap, 2015–16 to 2021–22

Line graph showing the confidence intervals for the individuals not in business income tax gap estimate. The trend result ranges from 5% to 8% at commencement to the results shown above.

The estimate from the random enquiry program is not the only component of this tax gap estimate. To establish the overall gap, we also draw on operational data for specific compliance risk areas. For example, we looked at the:

- failure by employers to withhold tax and report wage income of their employees
- non-lodgment of income tax returns
- non-payment of debts.

We combined the operational and random enquiry program findings to produce an overall gap estimate.

Updates and revisions to previous estimates

Each year we refresh our estimates in line with the annual report. Changes from previously published estimates occur for a variety of reasons, including:

- improvements in methodology
- revisions to data
- additional information becoming available.

This gap was first published in 2018 and has been revised 5 times annually. In 2019 we realigned the population and estimate to be consistent with the wider tax gap research program. In both 2022 and 2023 we increased the uplift for hidden wages non-detection, resulting in increases to historically revised estimates.

Figure 6 displays the net gap from our current model compared to all previously published estimates.

Figure 6: Current and previous individuals not in business income tax gap estimates, 2013–14 to 2021–22

The data used in Figure 6 is presented in Table 8 below.

Table 8: Summary of published net tax gap percentages for individuals not in business, 2013–14 to 2021–22

Gap release year	2013–14	2014–15	2015–16	2016–17	2017–18

2023–24	n/a	n/a	7.0%	6.9%	6.8%
2022–23	n/a	n/a	6.9%	6.8%	6.7%
2021–22	n/a	6.4%	6.5%	6.4%	6.4%
2020–21	5.4%	6.1%	6.2%	6.1%	5.9%
2019–20	5.6%	6.1%	6.2%	6%	5.6%
2018–19	5.6%	6.2%	6.4%	n/a	n/a
2017–18	5.8%	6.4%	n/a	n/a	n/a

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Reliability

Our current analysis and methodology for the individuals not in business income tax gap for 2021–22.

Published 1 November 2024

We seek feedback and advice about how we estimate the gap from our external and internal subject matter experts. Based on the advice, the reliability rating for this estimate is **high** with a score of 21.

The estimate draws on the results from the random enquiry program. It looks at all items on an income tax return and the taxpayer information we have received. Non-payment is also addressed. The gap has not

materially moved between years, giving us confidence in the results we are seeing.

Figure 7: Reliability rating scale from very low to very high – individuals not in business income tax gap

 Bar graph showing the reliability rating of high for the current individuals not in business income tax gap estimate. The rating scale includes very low (1-10), low (11-15), medium (16-20), high (21-25), very high (26-30).

In April 2023 the Australian National Audit Office (ANAO) found the ATO 'is largely effective at identifying and reducing the tax gap for individuals not in business'. There were also 2 recommendations made by the ANAO directly relevant to the tax gap analysis. The ATO has implemented these recommendations.

More detail can be found in [Identifying and reducing the tax gap for individuals not in business](#) .

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