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Tax cuts for those who need them

A proposal to change the Low-Income Tax Offset

Low-income workers are suffering the most from falling real wages. LITO changes could give them a $2,300 tax cut. This would be fully paid for by a 25% tax on gas exports. Key beneficiaries would be young people and those in regional areas, with National Party electorates benefiting the most.

Discussion paper

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Contents

Summary

Low-income workers are suffering after the largest ever fall in real wages. While real wages have grown more recently, the RBA is now expecting them to fall in 2026. While those on high incomes have more capacity to cut back their spending, low-income workers spend most of their income on essentials like rent, food, and utilities. They have far less capacity to cut back.

This paper proposes a targeted income tax cut for low-income workers by increasing the Low Income Tax Offset (LITO). The LITO is an automatic tax refund that low-income earners get when they lodge their tax return. It is effective in making sure the tax cut goes to those who need it most because it tapers down as people's incomes rise. This means high-income earners get no benefit from the LITO.

The biggest beneficiaries of this change in the LITO would be taxpayers earning between $32,000 and $46,000 per year. They would receive a tax cut of more than $2,000 per year. Those earning between $46,000 and $70,000 would get a tax cut of between $2,000 and $1,000 per year. Those earning between $70,000 and $90,000 would get a tax cut of less than $1,000. Those on more than $90,000 would get no tax cut.

This tax cut is likely to have a significant impact on labour force participation. Low-income workers often have childcaring responsibilities and the relationship between the after-tax hourly rate of pay and the hourly cost of childcare can be a major determinant of labour supply. Increasing their take-home pay can make working additional days financially viable.

This increase in the LITO can be fully paid for by a 25% tax on gas exports as proposed by the ACTU. This tax would only be payable on gas exported overseas and so would not increase gas prices paid by Australians.

This increase would be revenue positive, with the LITO changes costing $12 billion and the 25% gas export increasing revenue by $12.5 billion.

While gas companies have received extraordinary windfall profits in recent years, hard-working low-income Australians are facing a financial squeeze. This is an opportunity for more workers to receive the benefits of Australia's resources.

The benefits of this tax cut will be of greatest help to young people and workers in rural and regional areas. Rural and provincial electorates would get the largest average benefit, with electorates currently held by the National Party benefitting the most. Regional and outer suburban crossbench electorates also benefit considerably, while inner-city electorates would get the least.

Introduction

Real wages in Australia remain lower than they were before the COVID pandemic.[1] While some growth in real wages occurred after Labor won office in 2022, this growth has now stagnated. The Reserve Bank of Australia predicts that, after accounting for inflation, workers' wages will begin to fall in 2026.[2]

Low-income workers will be the worst hit by the decrease in real wages and so will need the most support. But with the Reserve Bank trying to slow aggregate demand because of concern about inflation, any government assistance will need to be tightly targeted.

This paper proposes a tax cut for low-income workers by reforming the Low Income Tax Offset (LITO). The advantage of the LITO is that it can provide tax cuts that are targeted just to these workers, without those cuts flowing through to those on high incomes. This lowers the cost of the change to the government relative to a change in broader tax settings.

Keeping in mind the RBA's concern with inflation, this paper also proposes that the tax cut for low incomes earners is offset with a corresponding increase in government revenue, specifically, a 25% tax on gas exports as proposed by the Australian Council of Trade Unions (ACTU).

[1] Jericho (2025) *The days of 4% pay rises are behind us – wages are now barely growing faster than inflation*, https://www.theguardian.com/business/grogonomics/2025/nov/19/wages-are-now-barely-growing-faster-than-inflation

[2] Reserve Bank of Australia (2026) *Statement on Monetary Policy: February 2026*, https://www.rba.gov.au/publications/smp/2026/feb/

Low-income workers and falling real wages

Low-income workers will bear the brunt of the declining real wages the RBA is expecting, for three distinct reasons:

- First, the wages of low-income workers have already been growing more slowly than those of high-income workers.
- Second, low-income workers save less money and spend less money on ‘discretionary’ items meaning they have far less ability than higher-income earners to reduce consumption as prices rise. The top 20% of Australian households by income, on average save around 40% of their weekly pay and spend significantly on overseas holidays, restaurant meals, private school fees and other luxury items.[3]
- Finally, over recent years, inflation has been strongest for non-discretionary items.[4] Non-discretionary items meet a basic need and it is difficult to reduce their consumption as prices rise. For example, rapid price increases in non-discretionary items such as rent and electricity have been apparent in recent years. Also, many grocery prices have seen large increases. Low-income workers spend a larger proportion of their income on non-discretionary items and so have been disproportionately impacted by this inflation.

One important way that the Government can provide significant relief to low-income earners is to provide targeted income tax cuts. With the Reserve Bank currently attempting to reduce demand, it is important to target tax cuts at those who need them, particularly as the increase in unemployment being pursued by the RBA is more likely to be focussed onto lower income workers.

Such tax cuts are important in the unique economic circumstances that Australia finds itself in. Put simply, a design feature of Australia’s progressive income tax system is that as incomes rise over time the average tax rate paid increases gradually.

However, as Australia is currently experiencing the unusual combination of rising nominal wages (the amount of money deposited into their accounts each fortnight) and falling real wages (the purchasing power of their nominal wage after adjusting for prices) the progressive tax system that usually captures more tax from those experiencing the fastest

[3] ABS (2022) *Australian National Accounts: Distribution of Household Income, Consumption and Wealth: 2021-22*, https://www.abs.gov.au/statistics/economy/national-accounts/australian-national-accounts-distribution-household-income-consumption-and-wealth/2021-22-financial-year

[4] ABS (2026) *Consumer Price Index – December 2025*, https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/consumer-price-index-australia/latest-release

income growth is actually capturing more tax from those whose real wages are falling fastest. In other words, millions of Australian workers are paying more tax even though their standard of living is declining. While increased tax revenue from such ‘bracket creep’ is not unusual, when nominal wages are rising rapidly and real wages are falling, the consequences of bracket creep become much more significant.

Take for example take ‘Kathy the cleaner’ earning $45,000 per year. The tax rates that apply in 2025-26 are set out in Figure 1.

Figure 1: Residential income tax rates in 2025-26

Taxable income	Tax on this income
0 – $18,200	Nil
$18,201 – $45,000	16c for each $1 over $18,200
$45,001 – $135,000	$4,288 plus 30c for each $1 over $45,000
$135,001 – $190,000	$31,288 plus 37c for each $1 over $135,000
$190,001 and over	$51,638 plus 45c for each $1 over $190,000

The above rates **do not** include the Medicare levy of 2%.

Source: ATO (2025) Tax rates – Australian resident

Kathy pays zero tax on her income up to $18,200 per year. She pays 16% (plus 2% for the Medicare Levy) on the $26,800 she earns between $18,200 and $45,000. In total she pays $4,863 in tax. Kathy has an average tax rate of 10.8% ($4,863/$45,000).

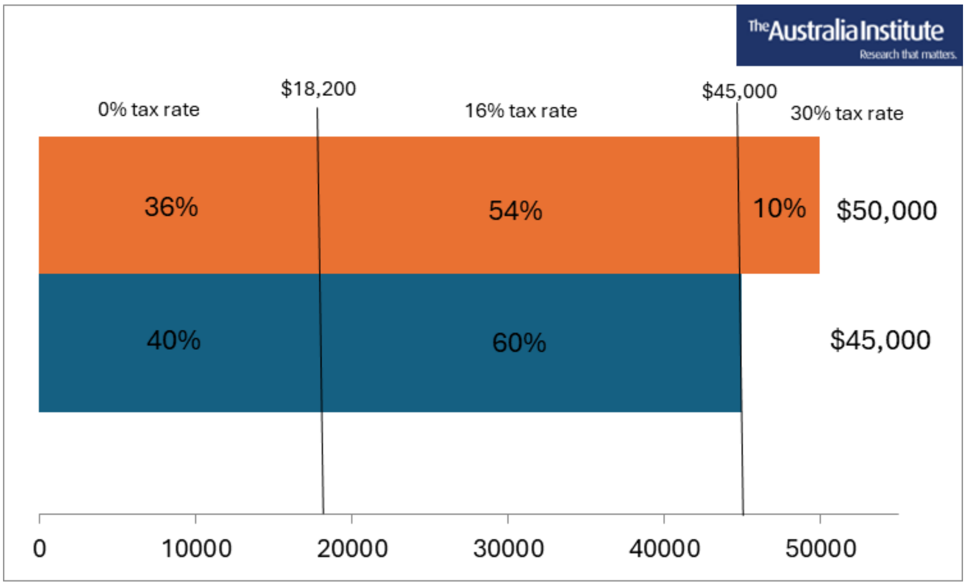
Over several years Kathy’s pay increases in line with the Consumer Price Index (CPI) until it reaches $50,000. While this represents a $5,000 increase in her nominal wage, her real wage, the amount of stuff she can buy, has not changed. It now costs $50,000 to buy the same amount of stuff that Kathy previously bought for $45,000.

But because of the increase in her nominal wage, Kathy’s final $5,000 is pushed into a higher bracket and taxed at 30% (plus 2% for the Medicare Levy). This sees her pay total tax of $6,538, and her average tax rate has increased to 13.1% ($6,538/$50,000). So, while her ‘real wage’ hasn’t increased (as it simply grew in line with inflation) her average tax rate, and most importantly her real disposable income, has fallen.

The interaction of the tax system and inflation means that even though Kathy’s real wage hasn’t changed, a larger proportion of her wage is now dedicated to paying tax, meaning she can no longer afford to buy the same stuff she could previously.

As Figure 1 makes clear, the increase in Kathy’s average tax rate is because a larger proportion of her income is now in a higher tax bracket even though her real wage is unchanged. When she earned $45,000 only 60% of her income was subject to tax. But after her pay rise, 64% of her income becomes subject to tax including 10% of her income becoming subject to a higher 30% rate (plus 2% for the Medicare Levy). This is shown graphically in Figure 2 below:

Figure 2: Breakdown of tax paid on $45,000 and $50,000 per year



Source: Author's calculations based on ATO tax rates

To be clear, if there was no inflation and Kathy's nominal and real wages were both growing each year then while her average tax rate would still be rising, her ability to buy more things would also be rising. But because of inflation, while her nominal wage has gone up, her real wage has remained unchanged and when this combines with a higher average tax rate it means her real, after-tax income has fallen.

It is this interplay between inflation and tax among the lowest paid workers that justifies the need for a significant increase in the LITO, at least until real wages begin to rise again.

Income tax cuts and labour participation

In addition to the equity implications of increasing the amount of tax paid by low-income earners at a time when the cost of the goods and services they purchase is rising faster than their wages, there are good macroeconomic reasons for focussing tax cuts on low-income earners. The most important reason is the potential benefit that the income boost would provide to labour supply.

Economists often assume that workers will supply more hours of work to their employer when their after-tax hourly rate of pay increases. Economists call this a 'labour-leisure trade-off'. This means that, every hour of time spent at leisure is viewed as an hour not spent at work. If the after-tax wage rate increases, then so too does the 'price of leisure'.

In turn when economists assume that price is the main determinant of how much leisure people 'buy', it follows that by lowering the tax rate the after-tax wage rate increases. This in turn increases the price of leisure, reducing the amount of leisure workers want and, most importantly to economists who assume such things, increasing the number of hours that workers are willing to supply to their employer.

Like most economic theory, the labour leisure trade-off is based more on assumptions than empirical data. This theory is often used to make a rhetorical case, for example, to cut the top marginal tax rate on the basis that doing so will lead high-income earners to work harder. This ignores the fact that high-income earners are often paid a fixed salary rather than paid by the hour and is based on an almost complete lack of evidence.

However, for low-income earners with caring responsibilities for children, the relationship between the after-tax hourly rate of pay and the hourly cost of childcare can be a major determinant of labour supply. Likewise, the cost of bus tickets and petrol can be an impediment to low-income earners accepting short shifts. In turn, if there is any segment of the labour market where worker hours are responsive to cuts in income tax it is part time workers on low hourly rates of pay like the workers who would be the overwhelming beneficiaries of the reform to the LITO proposed below.

In short, if the RBA and others are concerned about the economy reaching its capacity then increasing labour supply should be an obvious policy goal because a bigger workforce increases the productive capacity of the economy. Higher productive capacity can absorb more demand and hence increasing the LITO is an anti-inflationary policy.

A simple solution

To provide relief for low-income workers who are watching the amount of tax they pay rise as their real wages fall, a tax cut should be targeted at those workers specifically. However, the progressive design of Australia's income tax system makes this difficult. Simply increasing the tax-free threshold or reducing the lowest tax bracket's rate would not only provide a tax cut to low-income workers, but to all taxpayers. This would see a significant reduction in government revenues while not providing targeted assistance.

Luckily for policy makers who wish to target income tax cuts to low-income earners, a policy instrument called the Low Income Tax Offset (LITO) already exists and can be easily reformed to provide greater assistance to the targeted group. Unlike a tax cut for all taxpayers, the LITO in effect provides a bigger tax refund to workers who earn below the LITO threshold.

Currently the LITO provides up to $700, in the form of a tax refund for people earning up to $37,500.[5] For people earning over $37,500 the LITO gradually reduces by five cents for every extra dollar earned above $37,500. This means that the LITO reduces from $700 to $325 for those earning $45,000. Under the current rules, the rate at which the LITO tapers off is then reduced to 1.5 cents for every extra dollar of income above $45,000. This taper means that the LITO reaches zero by the time someone's income reaches $66,667.

Importantly, these thresholds were set in 2020-21 and have not been indexed as wages and prices have risen. This means that the percentage of people eligible for the LITO is falling each year (as nominal wages grow) even though their inflation adjusted (real) wages are declining.

While reducing the LITO is a much cheaper and more targeted way to reduce income tax than increasing the tax-free threshold, the cost of providing significant support to millions of low-income Australians is still significant. Before discussing the potential cost of reforming the LITO, we will discuss how this cost might be offset for those who are concerned about the impact on the budget deficit.

[5] Only tax paid can be refunded. If the taxpayer paid less than $700 in tax, rather than being refunded $700, they are refunded all of the tax they paid.

Tax on gas exports

Australia has an abundance of gas. In fact, Australia is one of the biggest exporters of gas in the world, alongside Qatar. Despite this abundance and the rapid increase in the amount of gas exported in the past decade, Australian gas is lightly taxed and contributes little to Commonwealth revenue. Indeed, the Commonwealth Government receives more revenue each year from repayments under the Higher Education Contribution Scheme (HECS) than it collects from its Petroleum Resource Rent Tax (PRRT).[6]

Around 80% of Australia's gas production is exported as liquefied natural gas (LNG), and the gas industry pays zero royalties on more than half (56%) the gas exported. Over the last four years, multinational companies made $149 billion exporting LNG based on royalty-free gas. If royalties had been charged on this gas, at least $13.3 billion in revenue could have been raised.[7]

Increasing the amount of tax that Australians collect on gas exports is, in the words of Nobel-Prize-winning economist, Professor Joseph Stiglitz, "a no brainer".[8]

One solution to more effectively tax the gas industry is the ACTU's proposed 25% tax on gas exports. This is a tax that would only be imposed on gas that was being sold overseas and would not be levied on gas sold in Australia. This 25% gas export tax is estimated to collect $12.5 billion per year.[9]

[6] Jericho et al. (2024) *Yes, the government collects more money from HECS than it does from the petroleum resource rent tax*, https://australiainstitute.org.au/post/yes-the-government-collects-more-money-from-hecs-than-it-does-from-the-petroleum-resource-rent-tax/

[7] Ogge et al (2024) *Australia's great gas giveaway: How Australia and the Northern Territory give gas to multinational corporations for free*, https://australiainstitute.org.au/report/australias-great-gas-giveaway-2/

[8] Robertson (2022) *The massive cost of not taxing gas companies revealed*, https://www.thenewdaily.com.au/news/politics/2022/08/02/gas-cost-of-not-taxing-companies

[9] Ogge (2025) *Submission to the Gas Market Review*, https://australiainstitute.org.au/report/submission-to-the-gas-market-review/

How to change the LITO to help low-income earners

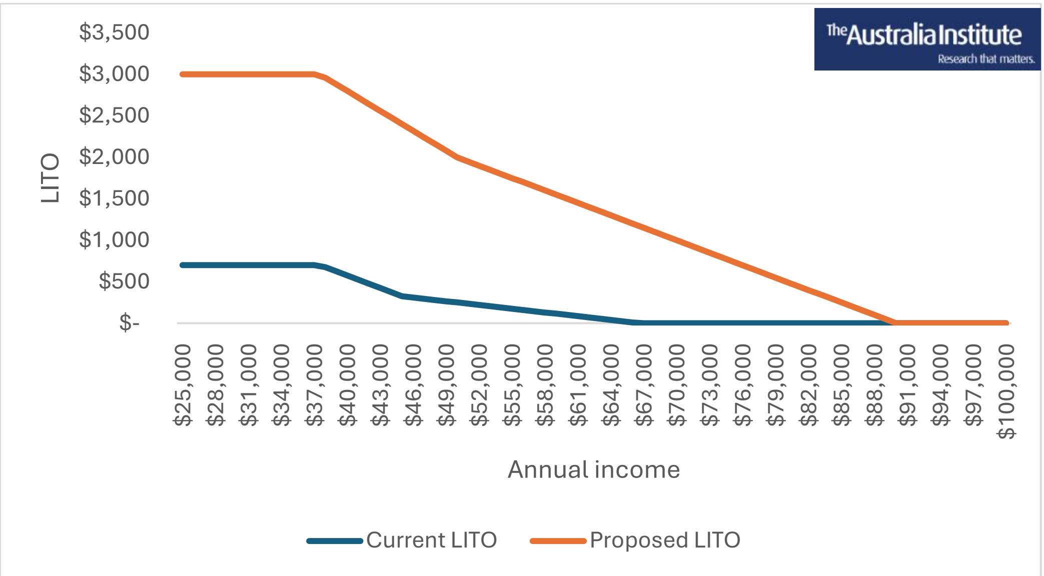
An increase in the LITO from its current maximum of $700 to $3,000 for people earning up to $37,500 would significantly boost the after-tax earnings of the lowest paid Australians.

Under this proposal the LITO would be reduced by 8 cents for every dollar earned above $37,500. Someone earning $37,500 would receive the full $3,000 (up from $700), while someone earning $50,000 would receive $2,000 (up from the current $325).

For those earning over $50,000, the taper would continue at 5 cents per dollar earned meaning the LITO would decline to zero at a taxable income of $90,000 (it currently cuts out at $66,667).

The size of the current and proposed LITOs for annual incomes between $25,000 and $100,000 are shown in Figure 3 below.

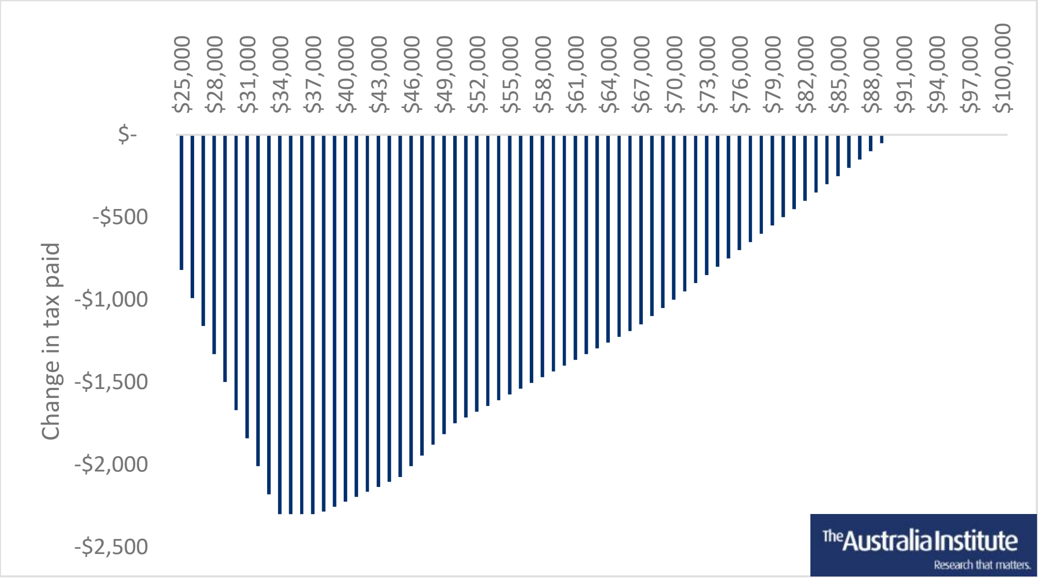
Figure 3: Current and proposed LITO payments by income



Source: Author’s calculations

In reality, many low-income earners pay less than $3,000 per year in tax, meaning that only people with special circumstances, or those earning around the $37,500 threshold would receive the full payment. Figure 4 below considers the effect of the proposed change for most income earners. It presents the size of the increase in the LITO by taking the old LITO from the new LITO. The negative numbers show taxpayers paying less tax.

Figure 4: Size of tax cut from proposed LITO for incomes between $25,000 and $100,000



Source: Author's calculations

Figure 4 shows that the biggest beneficiaries are taxpayers earning between $32,000 and $46,000 per year. They will receive a tax cut of more than $2,000 per year. Those earning between $46,000 and $70,000 get a tax cut of between $2,000 and $1,000 per year.

Cost of proposed LITO changes

This change to the LITO would reduce tax revenue by $12 billion in 2026-27.[10] This is less than the $12.5 billion in additional revenue that the 25% tax on gas exports is expected to raise. This means that the change is expected to be revenue positive for the budget, which is significant given how widespread the concern is that the size of the budget deficit is a significant contributor to inflation.

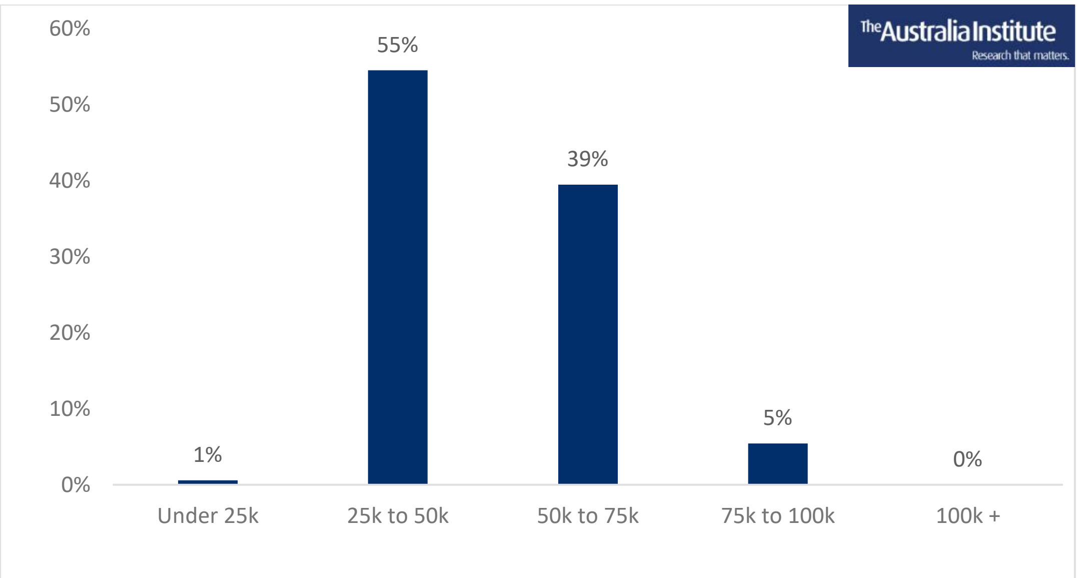
[10] Parliamentary Budget Office (2026) *Small Model of Australian Representative Taxpayers*, https://www.pbo.gov.au/publications-and-data/data-and-tools/SMART

Who are the major beneficiaries?

Beneficiaries by income group

As discussed above, by design the major beneficiary of this $12 billion tax cut would be low-income earners.[11] Figure 5 shows the proportion of the $12 billion that would flow to various income groups. Those earning between $25,000 and $50,000 would get most of the benefit (55%), with those earning between $50,000 and $75,000 getting the second largest share (39%). Those earning under $25,000 would get only a tiny amount (1%) because they currently pay very little tax. A small proportion (5%) would be given to those earning between $75,000 and $90,000, which is the point where the new LITO falls to zero.

Figure 5: Beneficiaries of proposed LITO change by income groups



Source: Parliamentary Budget Office (2026) Small Model of Australian Representative Taxpayers

Beneficiaries by age group

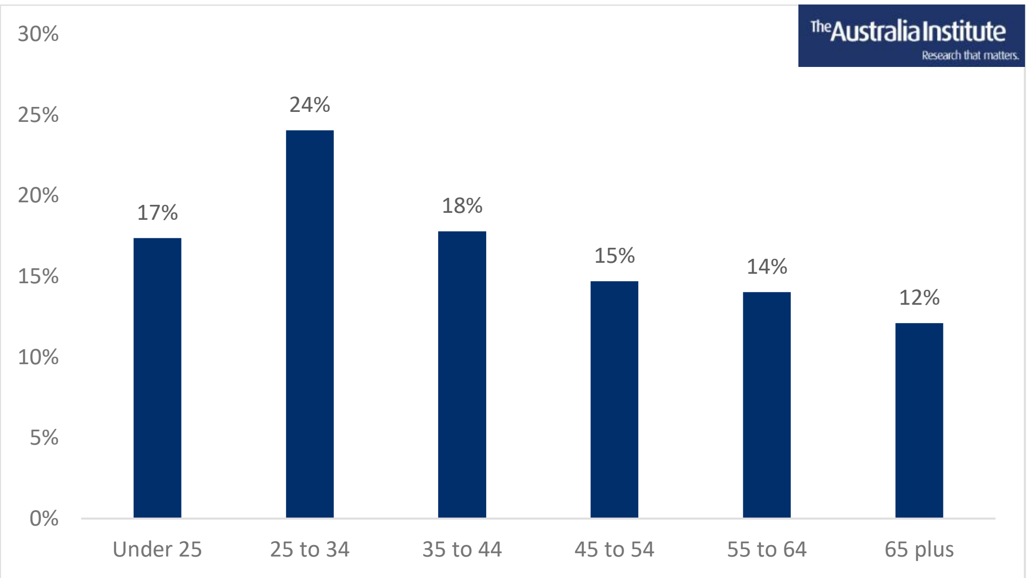
Younger people would benefit from LITO reforms as they generally earn lower incomes.[12] Figure 6 shows the proportion of the $12 billion tax going to each age group. The biggest beneficiaries are those aged 25 to 34 (24%). Those under 25 get less than this (17%) because this group is less likely to be in paid employment and more likely to be in full time education. The proportion going to each subsequent age group falls. Those aged over 65 get

[11] Ibid

[12] Ibid

the least (12%) because this group is less likely to be in paid employment, more likely to be retired and superannuation income is already entirely tax free.

Figure 6: Beneficiaries of proposed LITO change by age groups



Source: Parliamentary Budget Office (2026) Small Model of Australian Representative Taxpayers

Beneficiaries by region

The average benefit of increasing the LITO from $700 to $3000 has also been estimated by Commonwealth Electoral Division.[13] The Australian Electoral Commission has four demographic classifications for each electorate. They are:

- Inner Metropolitan: situated in capital cities and consisting of well-established built-up suburbs.
- Outer Metropolitan: situated in capital cities and containing large areas of recent suburban expansion.
- Provincial: outside capital cities, but with a majority of enrolment in major provincial cities.
- Rural: outside capital cities and without majority of enrolment in major provincial cities.[14]

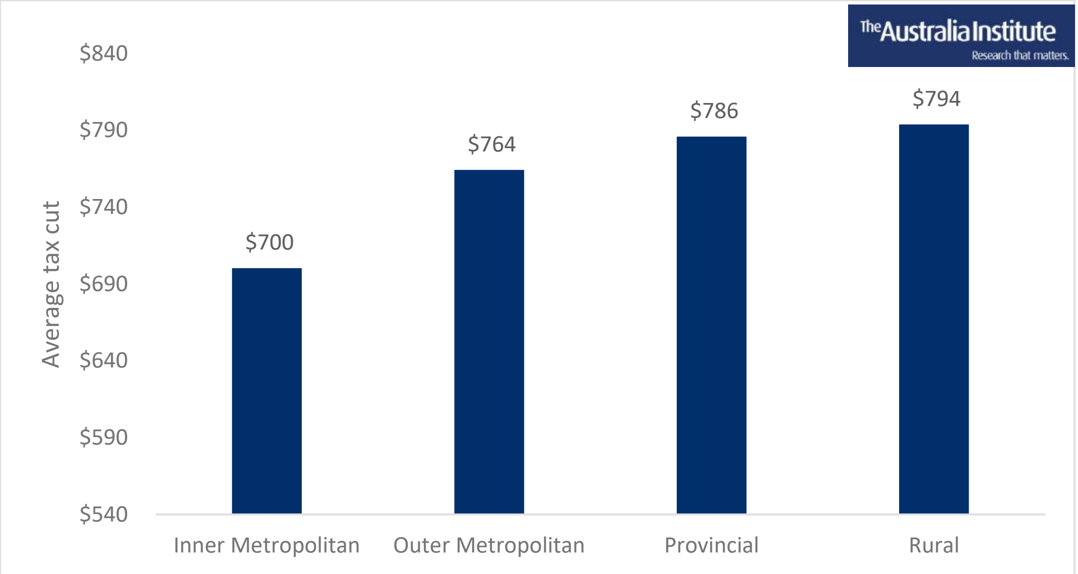
As shown in Figure 7 the demographic classification that receives the largest average benefit of increasing the LITO to $3,000 is rural electorates. This is followed by provincial and then outer metropolitan electorates. Inner metropolitan electorates would receive the lowest average benefit from an increase in the LITO. This pattern is due to the fact that rural areas

[13] For methodology see Appendix A.

[14] AEC (2025) *Demographic classification of electoral divisions at 4 March 2025*, https://www.aec.gov.au/electorates/maps.htm

have a much higher proportion of low-and middle-income earners who will receive the largest benefit from the increase to the LITO compared with those living in inner city electorates.

Figure 7: Average tax cut by demographic classification of electoral divisions



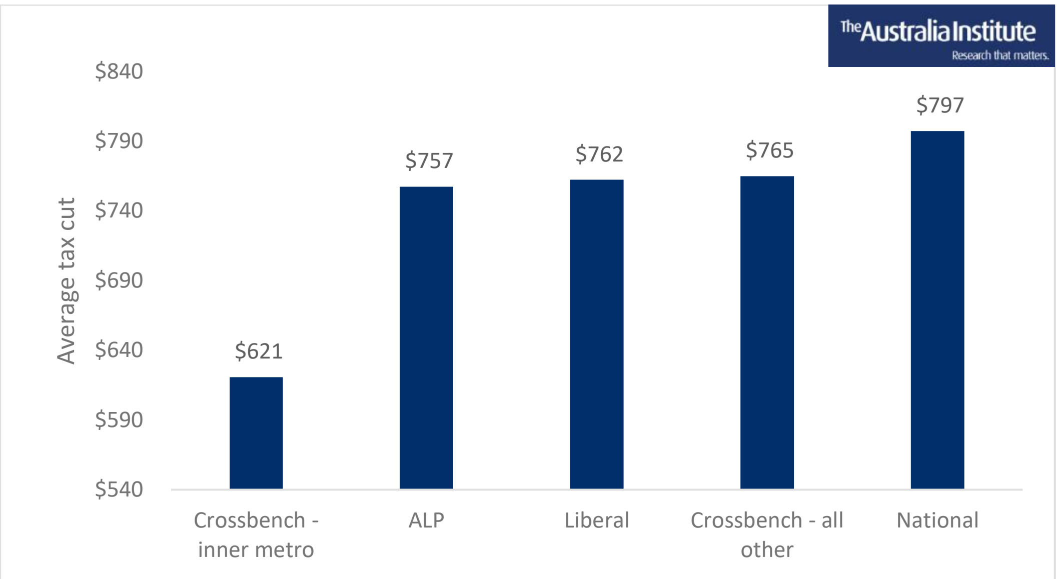
Source: Author's calculations, ATO (2025) Taxation Statistics 2022-23 – Table 7A, Parliamentary Budget Office (2026) Small Model of Australian Representative Taxpayers, AEC (2025) Demographic classification of electoral divisions at 4 March 2025

It is also possible to use the ATO tax statistics to calculate an average benefit by electorate and these results have been summarised for the electorates for each of the major parties (Labor, Liberal, and National) as well as the crossbench[15] and presented in Figure 8 below.

It shows that National Party electorates would receive the biggest benefit of an increase in the LITO to $3,000, followed by the crossbench electorates that are not in inner-metro areas. Liberal party electorates, few of which are in the cities, come next, then Labor and finally the inner-city, inner-metro areas receive the smallest benefit as these once blue-ribbon Liberal seats are among the most affluent seats in the country.

[15] The crossbench electorates have been separated into those in inner-metropolitan areas and those in all other areas. This was done because about half of the crossbench electorates are in inner-metropolitan areas (6 of 13) and they are significantly different from all the other crossbench electorates (7 of 13), which are predominately in rural electorates.

Figure 8: Average tax cut by party and crossbench groupings



Source: Author's calculations, ATO (2025) Taxation Statistics 2022-23 – Table 7A, Parliamentary Budget Office (2026) Small Model of Australian Representative Taxpayers, AEC (2025) Demographic classification of electoral divisions at 4 March 2025

Conclusion

The combination of rising inflation, falling real wages and a progressive income tax system is driving a significant reduction in after-tax income for low-income Australians and in turn a significant increase in inequality in Australia. The possibility that falling real wages would be accompanied by a higher absolute tax bill and rising average tax rates was not one anticipated by the architects of Australia's progressive income tax system.

Luckily, the existence of the LITO and the ability to efficiently and equitably collect over $12.5 billion per year by simply imposing a 25% tax on all gas exports means that it is easy for this parliament to simultaneously reduce income inequality, ensure Australians get a fair price for the sale of their natural resources, and increase the labour force participation rate. All while improving the budget balance and by implementing policies that are widely supported in the electorate.

Taxpayers in regional seats have the most to gain. These seats are currently the battleground for the Liberal, National, One Nation and Katter Australia parties. Given the Greens stated support for reducing inequality and taxing the gas industry more fairly, it would be straightforward for the Albanese Government to build public and parliamentary support for such a simple change.

Indeed, apart from the lobbying power of the gas industry, it is hard to see why any government would not pursue a policy reform as simple and equitable as that proposed in this paper. That said, the largely foreign-owned gas industry is notoriously effective at persuading Australian governments to put the interests of the gas industry ahead of the interests of the majority of Australians.

Whether the contest between the Nationals, One Nation and Katter Australia for voter support is sufficiently heated to see one or more of those parties pursue voters ahead of the praise and donations from the gas industry will play a major role in the shape of the policy contest in this parliamentary term. Given that the Liberals, Nationals and One Nation all proposed new taxes on the gas industry in the lead-up to the 2025 election, both gas policy and electoral politics have the potential to shift rapidly in the next two years.

Appendix A

Tax data that showed the number of taxpayers in each tax brackets by postcode[16] has been assigned into Commonwealth Electoral Divisions using an ABS correspondence.[17] Where postcodes crossed electoral division boundaries, the postcode was assigned to the electoral division that had the largest proportion of that postcode. This data was then used to split the number of taxpayers in each electoral division into those earning up to $45,000 per year and the number of taxpayers earning more than $45,000 per year.

Data from the Parliamentary Budget Office's Small Model of Australian Representative Taxpayers (SMART) was used to calculate the cost of the change to the LITO.[18] This model also supplies the dollar value of benefit going to eight income groups. The relevant groups for this exercise include under $25,000, $25,000 to $50,000, $50,000 to $75,000 and $75,000 to $100,000. Using the results for financial year 2026-27 they were aggregated to calculate the total benefit going to those earning up to $50,000 and those earning more than $50,000.

The tax data group of those earning up to $45,000 was used as a proxy for the SMART data group for those earning up to $50,000. The same was done for tax data group earning more than $45,000 and the SMART data group for those earning more than $50,000. The amount of benefit was the calculated by electorate.

To improve the robustness of this data, the by electorate data was then aggregated into larger groups and presented in this paper. These groups included by demographic classification and by party.

[16] ATO (2025) Taxation Statistics 2022-23 – Table 7A, https://data.gov.au/data/dataset/taxation-statistics-2022-23/resource/6a80da31-8f46-4b09-bb88-6a3361b43e11

[17] ABS (2026) *Correspondences*, https://www.abs.gov.au/statistics/standards/australian-statistical-geography-standard-asgs-edition-3/jul2021-jun2026/access-and-downloads/correspondences

[18] Parliamentary Budget Office (2026) *Small Model of Australian Representative Taxpayers*, https://www.pbo.gov.au/publications-and-data/data-and-tools/SMART