THE TAX INSTITUTE

THE MARK OF EXPERTISE

7 March 2014

The Hon Josh Frydenberg MP
Parliamentary Secretary to the Prime Minister
PO Box 6022
House of Representatives
Parliament House
CANBERRA ACT 2600

By email: j.frydenberg@aph.gov.au

Dear Mr Frydenberg

Deregulation in the tax system

For your information, please find **attached** a copy of a letter sent to your colleague, Mr Michael Sukkar MP, regarding the Tax Institute's initial thoughts on reducing regulatory burden in the tax system.

The Tax Institute supports the Government's deregulation initiative and the publishing of a regulation impact statement in respect of each new tax measure. Careful consideration should be given to how the success of this initiative ought to be measured. It is our view that this initiative should be clearly distinguished from the repeal of redundant provisions, with the focus being on genuine time and cost savings for users of the tax system.

The Tax Institute is supportive of this initiative as it will positively contribute to the simplification of the Australian tax and transfer system and reduce the overall compliance burden associated with tax obligations that Australian taxpayers are required to meet. With the complexity that surrounds Australia's tax and transfer system, there are a myriad of opportunities for reform ranging from specific policy changes to administrative changes, duplication of information requests, inefficient forms of election and streamlining opportunities to name just a few.

If you would like to discuss any of the above, please contact either me or Senior Tax Counsel, Robert Jeremenko, on 0468 987 300.

Yours sincerely

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6 March 2014

Mr Michael Sukkar MP
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MITCHAM VIC 3132

By email: Michael.Sukkar.MP@aph.gov.au

Dear Mr Sukkar

Deregulation in the tax system

The Tax Institute welcomes the opportunity to provide some initial thoughts on reducing Australia's regulatory burden by $1 billion annually.

The Tax Institute supports the Government's deregulation initiative and the publishing of a regulation impact statement in respect of each new tax measure. Careful consideration should be given to how the success of this initiative ought to be measured. It is our view that this initiative should be clearly distinguished from the repeal of redundant provisions, with the focus being on genuine time and cost savings for users of the tax system.

Further, deregulation should not be at the expense of sound reform in areas such as the regulation of financial advisers providing tax advice and reform of trust taxation discussed above. The deregulation initiative should not be used to avoid addressing these complex but necessary areas requiring tax reform.

The Tax Institute is supportive of this initiative as it will positively contribute to the simplification of the Australian tax and transfer system and reduce the overall compliance burden associated with tax obligations that Australian taxpayers are required to meet. With the complexity that surrounds Australia's tax and transfer system, there are a myriad of opportunities for reform ranging from specific policy changes to administrative changes, duplication of information requests, inefficient forms of election and streamlining opportunities to name just a few.

Opportunities for Deregulation in the tax system

We have approached our wide membership base over the Christmas/New Year period for suggestions as to areas in the tax system where the deregulation initiative could start to be targeted.

During this short period, members suggested some areas that would serve as a good starting point for deregulation to occur in the tax system. These are:

1. **Accessibility to Tax Return Forms**

The Australian Taxation Office (**ATO**) is moving towards requiring all tax returns to be lodged electronically (via the Portal). However, there are many returns and associated forms that cannot yet be lodged electronically and so a paper return must be prepared. Currently PDF copies of certain forms (such as *Company Tax Return 2013*) are unable to be downloaded electronically and must be ordered from the ATO. Time is spent waiting for the forms to be delivered. The forms must then be completed by hand and if a mistake is made, the form must be started again. It is much quicker to complete a soft copy of a form than a hard copy.

Until all forms can be lodged electronically, soft (PDF) copies of the forms that can be completed electronically should be made readily available and should also be able to be lodged with the ATO.

2. **Reporting for closely held trusts**

a) TFN Reporting

The TFN reporting rules for closely held trusts are contained in Division 4B of Part VA of the *Income Tax Assessment Act 1936* (Cth) (**1936 Act**). A trustee of a closely held trust must register for PAYG withholding. Withholding applies where the trustee has not received a TFN from a beneficiary by the time the trust tax return is due for lodgement.

As a result, a trustee of a closely held trust has the following reporting obligations:

- they must lodge a report each quarter (ie a “TFN Report”) detailing the personal details and tax file number (**TFN**) where a beneficiary quotes their TFN to the trustee in the quarter. This requires a trustee to complete an 8 page ATO form (NAT 73651-02.11) for each quarter where a beneficiary advises the relevant information;
- they are required to lodge an annual “TFN Withholding Report” if amounts have been withheld from payments made to beneficiaries who have not provided their TFN to the trustee;
- a trustee must also include in the tax return for a trust a report of amounts distributed to beneficiaries that would have been subject to withholding had the trustee not provided their TFN; and

- a trustee must give beneficiaries an annual payment summary following the lodgement of the TFN Withholding Report.

There seems to be some level of duplication in the information required to be provided through the suite of reporting obligations noted above, particularly with the requirement to prepare the TFN Report each quarter a beneficiary notifies the trustee of their TFN. It seems that the requirement to include the TFN Report is surplus to the other reporting requirements imposed on the trustee.

These reporting requirements could be condensed and the relevant information included on a statement together with the tax return form including the following:

- the amounts tax has been withheld from;
- the amounts tax would have been withheld from if the beneficiary had not provided their TFN;
- relevant details of the beneficiaries who have provided TFN details throughout the year.

b) TB Statements

A trustee of a closely held trust must also prepare a "TB Statement" which details which beneficiaries of the closely held trust are actually trustees of other trusts (ie they are a "trustee beneficiary"). This information could also be detailed in the trust tax return or separate statement lodged with the return that details information about the other beneficiaries (including distributions received, amounts withheld, their TFNs etc).

3. Transfer Pricing

Included in Appendix A are a series of suggestions for making improvements to compliance with the transfer pricing rules contained in Division 815 of the *Income Tax Assessment Act 1997* (Cth) (**1997 Act**).

4. Division 7A Loan Agreements

To ensure a loan from a private company to a shareholder complies with the requirements of Division 7A[1] and is not treated as a deemed dividend, a written loan agreement must be entered[2]. We suggest that evidence of whether the loan meets the requirements of Division 7A (eg it is for a 7 year term at the benchmark interest rate) could simply be drawn from the basis on which the loan is being repaid. This would eradicate the need for the loan documentation which may be required to be prepared by an advisor[3] for which the shareholder or company incurs a fee. If necessary, a payment schedule for the loan could be required instead.

[1] Of Part III of the 1936 Act
[2] See section 109N of the 1936 Act
[3] Eg a lawyer

5. Individual Taxation

We are aware that the ATO has made a move towards streamlining tax returns for individuals with simple tax affairs. However, there is further work that could be done to further simplify the compliance burden imposed on individual taxpayers who are required to lodge a return in an income year. Some suggestions are:

a) **Income Tests:** Currently there are a variety of definitions for "income tests" including Adjusted Taxable Income (**ATI**), Rebate Income, Income for Surcharge Purposes, and Income for Contribution Purposes. Having only one or two definitions available for "income tests" that apply when declaring certain information on an Individual Tax Return would be helpful even though it could make means testing less targeted. For example, ATI; or ATI with some modifications; or ATI and one other test, could be used instead of a range of different income tests for different purposes.

b) **Personal Services Income (PSI):** PSI compliance could be simplified greatly by allowing a personal services entity (**PSE**) to pay a PAYG instalment amount calculated by the ATO, rather than the PSE having to determine the amount of the PAYG instalment by applying the current rules which are quite complicated. Two possible solutions are:

(i) The ATO should be able to allow a PSE to report income annually with a PSI payment summary due for lodgement with the income tax return or on an annual payment summary statement and not require the PSE to include information at Labels W1 and W2 on the BAS at all during the year. The individual would receive PSI with no tax withheld, so they would enter the PAYG instalment system and could elect to pay an amount or use the instalment rate as ordinarily applies to other income subject to the PAYG instalment system; or

(ii) As above, but ATO advises the PSE of an amount uplifted by the GDP uplift factor they currently use to calculate instalment amounts. The PSE then uses that number to pay a withholding amount on a periodical basis, then those amounts would be reconciled at year end with the normal end of year lodgements.

6. Taxable payments reporting in the building and construction industry

From 1 July 2012, businesses in the building and construction industry became required to prepare and lodge a "Taxable Payments Annual Report" detailing payments made to contractors for building and construction services in the income year as well as amounts withheld from payments made to contractors who did not provide an Australian Business Number (**ABN**).

The stated purpose of this additional reporting is to capture payments made to contractors to "improve compliance with tax obligations by those contractors who are currently not doing the right thing[4]". The ATO will use the information obtained to match data received from persons who have made payments to a contractor and the income that contractor declares.

On the ATO website, it is noted that payments reported where an amount has been withheld because an ABN has not been provided do not need to be included on the "PAYG withholding where ABN not quoted - annual report[5]" as it will result in duplication of reporting of these amounts.

We are concerned that this requirement serves to increase compliance on already-compliant taxpayers and may not have the desired effect of making non-compliant taxpayers in the building and construction industry compliant. Therefore, the effectiveness of the regime, particularly where there is already a facility that allows for the reporting of payments made where an amount has been withheld because an ABN has not been quoted, is questionable.

7. Foreign exchange for small entities

Where an Australian-resident entity transacts with other group entities that are not residents of Australia, for example buying and selling goods, often the transactions will be recorded in an inter-company loan account. Depending on the volume of transactions, it may become quite onerous to constantly recognise adjustments for foreign exchange.

A retranslation method applies to a "qualifying forex account[6]", such as a bank account, which is simpler to apply than the usual "first-in first-out" ordering rule to calculate the cost or value of a fungible foreign currency asset, right or obligation. The retranslation method allows total gains or losses to be accounted for on a periodical basis, rather than each time a deposit is made into the account or withdrawal is made from the account.

We suggest that a simplified method for recognising foreign exchange gains and losses on inter-company loans similar to the retranslation method, should be made available.

8. Small business CGT concessions

The operation of the current small business CGT concessions is problematic due to the complex nature of the rules. The provisions are so complex that it is difficult for a small business to confirm that they qualify for a concession under the rules.

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[4] Refer to http://www.ato.gov.au/Business/Building-and-construction/In-detail/Taxable-payments-reporting/Taxable-payments-reporting---building-and-construction-industry/ on the ATO website for further information

[5] See http://www.ato.gov.au/Business/Record-keeping/In-detail/Electronic-record-keeping---reporting/How-to-lodge-your-PAYG-withholding-annual-reports-electronically/?page=17

[6] Under the foreign currency gains and losses rules contained in Div 775 of the 1997 Act

By way of illustration, uncertainty can arise in not knowing precisely how the concessions may apply to a particular taxpayer. For example, where assets are owned by spouses in discrete businesses, it is difficult to know if they will be aggregated by the ATO for the purpose of determining if the relevant thresholds for the concessions have been exceeded on the basis of control by the spouses of each other's businesses.

It is also unclear what valuations small businesses have to keep on file for the purpose of proving that the relevant thresholds are not exceeded.

Seeking advice on whether the concessions could apply can prove too costly for some taxpayers due to the complexity of the rules. The rules were intended to provide a simple tax concession, but they have become so complex that taxpayers often find it is not worth their while trying to determine if the concessions apply. Therefore, should the Government wish to continue to make available CGT concessions to small businesses, the concessions should be simplified to make them more easily understood and more readily able to be applied.

Other

To assist with this ongoing initiative, The Tax Institute will continue to look for further opportunities for reducing regulation and the compliance burden of the Australian tax and transfer system. We will use the various options open to us, such as liaising with the Deregulation Division in Treasury and through our regular consultation activities with the ATO, to assist the Government with this initiative.

We also refer you to a paper presented at the recent *2014 Australasian Tax Teachers Association Conference* entitled "Tangled up in Tape: The Continuing Compliance Plight of the Small and Medium Enterprise Business Sector" which details the results of a survey conducted by the Australian Research Council in early 2013 investigating the tax compliance costs of Australian SMEs in the 2012 fiscal year. It contains some useful information regarding where Australian SMEs most feel the burden of tax compliance.

If you would like to discuss any of the above, please contact either me or Senior Tax Counsel, Robert Jeremenko, on 0468 987 300.

Yours sincerely

Michael Flynn
President

Appendix A

Transfer Pricing
(as suggested by members)

- Adopt a similar approach to the UK (see section 166 of *Taxation (International and Other Provisions) Act 2010* Chapter 8) by:
  - Exempting small businesses from the operation of the transfer pricing rules; and
  - Exempting medium-sized businesses from the application of the transfer pricing rules but subject to enabling the ATO to issuing a notice (or similar) to a particular medium-sized enterprise in certain limited circumstances which would then require that entity to calculate its taxable income for a particular period in accordance with the transfer pricing rules.

  Although the ATO accepts that small and medium enterprises can apply a form of cost/benefit approach to their preparation of transfer pricing documentation, the new requirements of Division 815[7] to have documentation in place in order to have a reasonably arguable position potentially places a disproportionate burden on small and medium enterprises that happen to have dealings with foreign associates.

  For the purposes of the UK law, small and medium enterprises are defined as follows:

	Maximum number of staff	**AND less than one of the following limits:**	
		Annual turnover	Balance sheet total assets
Small Enterprise	50	€10 million	€10 million
Medium Enterprise	250	€50 million	€43 million

  The above suggestions were discussed on pp13/14 of The Tax Institute's submission[8] dated 12 April 2013 to the Senate Standing Committee on Economics on *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013* (albeit in the context of record-keeping requirements and penalties).

- Exempt small businesses from needing to complete section A of the International Dealings Schedule (the current $2 million threshold is too low).

- Introduce legislated safe harbours into the transfer pricing rules with respect to interest rates on cross-border related party debt (as an example, New Zealand and other countries have already done this).

[7] 1997 Act
[8] http://www.taxinstitute.com.au/submissions/tax-laws-amendment-countering-tax-avoidance-and-multinational-profit-shifting-bill-20131

Interaction between transfer pricing rules and thin capitalisation rules

- Amend the transfer pricing rules to ensure that where a taxpayer's gearing ratio falls within the safe harbour ratios in the thin capitalisation rules that a taxpayer's debt deductions are priced for the purposes of the transfer pricing rules on the basis of the taxpayer's actual gearing ratio and not by reference to a notional arm's length capital structure – recommended on pp6/7 of The Tax Institute's submission[9] dated 19 July 2013 to Treasury on the Proposals Paper entitled "*Addressing profit shifting through the artificial loading of debt in Australia*" dated June, 2013.

- Exempt small to medium enterprises from having to show that their capital structures are consistent with arm's length conditions for the purposes of the transfer pricing rules where they become exempt from the thin capitalisation provisions as a consequence of the proposed increase in the *de minimis* threshold from $250,000 to $2 million – raised on pp 4/5 of The Tax Institute's submission[10] dated 19 July 2013 to Treasury on the Proposals Paper entitled "*Addressing profit shifting through the artificial loading of debt in Australia*" dated June, 2013.

Attribution of profits to permanent establishments

- Introduce legislation to adopt the Authorised OECD Approach (AOA) with respect to the attribution of profits to permanent establishments – As stated on page 7 of The Tax Institute's submission[11] dated 19 December 2012 to the Board of Taxation in relation to the *Review of Tax Arrangements applying to Permanent Establishments* Discussion Paper, The Tax Institute regards the OECD's AOA as fundamentally superior to the current treatment for attributing profits to permanent establishments applied in Australia.

[9] http://www.taxinstitute.com.au/submissions/addressing-profit-shifting-through-the-artificial-loading-of-debt-in-australia
[10] http://www.taxinstitute.com.au/submissions/addressing-profit-shifting-through-the-artificial-loading-of-debt-in-australia
[11] http://www.taxinstitute.com.au/submissions/review-of-tax-arrangements-applying-to-permanent-establishments