



THE TAX INSTITUTE
THE MARK OF EXPERTISE

22 February 2017

Mr Jerome Brown
Committee Secretary
House of Representatives Standing Committee on Tax and Revenue
PO Box 6021
Parliament House
CANBERRA ACT 2600

By email: TaxRev.reps@aph.gov.au

Dear Mr Brown,

Inquiry into Taxpayer Engagement with the Tax System

The Tax Institute welcomes the opportunity to make a submission to the House of Representatives Standing Committee on Tax and Revenue (**Committee**) in relation to the *Inquiry into Taxpayer Engagement with the Tax System* (**Inquiry**).

Summary

The view of The Tax Institute has always been that the most effective tax system would be simple, equitable and effective. It would also not require any need for taxpayers to interact with the tax administration at all, nor would the tax administration be required to interact with taxpayers.

The significant number of taxpayers who rely on tax agents and intermediaries to assist them with their tax compliance obligations do so because there is so much complexity in Australia's tax system¹.

Further moves towards digitisation and overall simplification in the tax system should assist with increasing taxpayer engagement.

¹ For further discussion about complexity in Australia's tax system, we refer you to The Tax Institute's 2017-18 Federal Budget submission: <https://www.taxinstitute.com.au/tisubmission/federal-budget-submission-2017-18>.

Discussion

1. About The Tax Institute

The Tax Institute is Australia's leading professional association and educator in tax providing the best resources, professional development and networks. With over 12,000 members, our mission is to educate and build expertise in tax and to raise the status of the tax profession.

Our growing membership base includes tax professionals from commerce and industry, academia, government and public practice throughout Australia. Our reach extends to over 40,000 Australian business leaders, tax professionals, government employees and students through the provision of specialist, practical and accurate tax content.

We represent a significant number of tax agents and other intermediaries involved in the tax profession. Hence our comments below relate to how members represent taxpayers in the tax system.

The Tax Institute has chosen to address only select points raised by the Inquiry as detailed below.

- *How taxpayers currently interact with the tax and superannuation system, including through tax agents and other intermediaries, and the different compliance burdens of doing so*
- *The contemporary use of information and communication technology by the Australian Taxation Office and comparative tax administrators to deliver services*

2. General

The most effective tax system would be simple, equitable and effective. Ideally, it would also not require any need for taxpayers to interact with the tax administration at all, nor would the tax administration be required to interact with taxpayers.

This description of an effective tax system does not reflect the Australian tax system in its current form. In Australia, the tax system is complex. All taxpayers interact to varying degrees with the tax administration, the Australian Taxation Office (**ATO**), and the administration with them. Inevitably this influences taxpayer engagement with the tax system – to what extent a taxpayer will willingly or will be unwilling to engage with the system and their need for the assistance of an intermediary to engage.

Taxpayers tend to engage with a tax system and comply with their obligations if they perceive the system as transparent and fair – hence the need for the tax system to be both simple (and therefore more transparent) and equitable. Overseas studies undertaken in the United Kingdom and Europe support this view².

However, we do not anticipate that simplification alone will necessarily alleviate the need for taxpayers to require the assistance of an agent or intermediary. While simplification may assist to remove the need for assistance with routine compliance work, there will likely always be a place for tax agents and intermediaries to assist with more complex matters, such as higher level tax and business analysis and advice.

3. Reliance on tax agents and intermediaries

Taxpayers who engage tax agents and intermediaries do so for a number of reasons, including:

- They find it difficult to understand their obligations, due to the complexity in the Australian tax law and administration of the system;
- They consider they may be paying too much tax and therefore seek an expert opinion to see if there is an alternative;
- They seek comfort from gaining the opinion of an expert regarding the tax implications of a particular transaction that may be outside the ordinary course of their business, because it may be larger than usual or not previously done;
- They have misgivings about their direct interactions with the ATO and therefore seek an intermediary to assist with those interactions;
- They are simply too busy to spend the time looking after their own tax obligations and simply outsource the responsibility to a perceived expert, such as an agent or other intermediary;
- They understand and value the utility of being able to access the expert advice and assistance of a tax agent or intermediary.

As such, a large majority of individual taxpayers and an even larger majority of business taxpayers utilise the services of a tax agent to assist them to understand and meet their tax compliance obligations and for their dealings with the Australian Taxation Office (**ATO**). Recent ATO statistics indicate that 74.2% of individuals lodge their income tax return via a tax agent³, which is a strong indication that taxpayers are heavily reliant on agents to meet their tax obligations. However, use of tax agents is not consistent across all taxes, nor all interactions with the ATO.

² For example, OECD *Tax and Development: What drives tax morale?* http://www.oecd.org/ctp/tax-global/TaxMorale_march13.pdf

³ <https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Taxation-statistics/Taxation-statistics-2013-14/?page=4#IndividualsSummarytables>

The high incidence of use of tax agents and intermediaries in Australia would probably be among the highest of the OECD countries and is a reflection of the complexity and difficulty that taxpayers have in engaging with the tax system. In particular, there would be a great majority of individual taxpayers with straightforward tax affairs who unnecessarily engage a tax agent simply because of the amount of misinformation available in relation to the tax system, mixed in with the correct information. They find it difficult to sort the correct information from the incorrect information, or are simply unsure, and therefore require the assistance of an expert intermediary. Such taxpayers should be able to rely on the correct information and guidance, as issued by the ATO, to satisfy their compliance obligations without the need for assistance from a third party.

4. Increasing use of software

There is increasing use of software to simplify compliance in line with the broader government position of 'digital by default', that is interactions with government via digital platforms, which The Tax Institute welcomes.

Digital interactions with the ATO

The ATO should be applauded as it is regarded by our members as a trustworthy, reliable and generally fair organisation to deal with. It is also open to criticism and learns from its mistakes. It also seeks to provide assistance to taxpayers (and their agents and intermediaries), albeit with varying levels of success, and is open to reasonable discussion and negotiation. The professionalism of the ATO in this regard should be encouraged, rewarded and built on.

The ATO has worked hard to make electronic and online interactions as easy as possible, with continuing work to improving these interactions. This is critical as the system moves more and more towards online interactions, particularly as there are more and more online (whether locally, externally or cloud hosted) software packages now available that allow taxpayers to send data to the ATO without the need for tax agent intervention. In this regard, it would seem that online interactions with the ATO are moving further in the direction towards being close to real time interactions – for example the 'Single Touch Payroll' initiative.

The change to real time on-line financial data recording means that for 'routine' or algorithmic data, clients are more likely to interact with the ATO directly as it is now easier to do so. Clear examples of this are PAYG Withholding annual reconciliations and GST calculations for submission with Business Activity Statements in 'simple' circumstances. This is to be encouraged, but without losing sight of the heavy reliance that taxpayers still have on tax agents in the tax system.

Notwithstanding the trend for direct contact for supposedly simpler matters, often there needs to be an exercise of informed judgement behind even those matters to ensure that the 'routine' data reflects correct characterisation of underlying transactions. A well

-educated and experienced tax adviser community will thus continue to be essential to the operation of the system, and government ought therefore to do as much as possible to support those professional tax advisers who are striving to operate at high standards. (The ATO is nevertheless to be applauded for its efforts to improve awareness among taxpayers in general, not just tax professionals.)

However, we suggest there are some areas where improvements could be made, including:

- The ATO should provide as much 'pre-filled' information as possible to make it as easy as possible for taxpayers to comply. We understand that work continues in this area.
- There should be closer interaction between the software providers and the ATO's forms used for compliance and administration to enable as much automation as possible.
- There should be better transparency in data collected by the ATO and that data should be made available in a more user friendly format. This would assist with making online interactions with the ATO easier.

Though, with ever increasing reliance on IT systems, regular maintenance and upgrades are required. These would need to be properly resourced and scheduled with sufficient warning given if they are going to affect users of the systems (taxpayers and their agents / intermediaries) given the likely disruption to business from an outage of an IT system (due to maintenance or otherwise).

5. Future direction

We note that the tax system is unusually heavily reliant on intermediaries, as compared to other government systems. This 'feature' will need to be taken into account in considering the future direction of the tax system, particularly with respect to taxpayer engagement.

Simplification of the tax system

Simplification of the tax law, the administration of the tax law and the general functioning of the tax system is vital to improving taxpayer engagement with the tax system. This is central to an effective tax system being simple, equitable and effective.

Ideally, this would result in removing the need for a majority of taxpayers to lodge a tax return. Particularly in the case of individual taxpayers, Australia is out of step with other OECD countries where final withholding and the absence of availability of deductions for 'work-related related expenses' is generally the norm and is used to ensure individuals are not required to lodge a tax return.

Efforts to simplify the tax system would benefit taxpayers and the ATO alike with the overall burden on the main players in the tax system (taxpayers and the ATO) being reduced.

Example – taxation of individuals

For individuals that are subject to marginal rate taxation, there is a lack of transparency in the marginal tax rate system. Aside from the stated marginal rates, these are impacted by additional factors such as the 2% Medicare levy, the Medicare levy surcharge, the low income tax offset and HELP repayments to name a few. The Tax Institute supports the application of a transparent marginal tax rate system to individual taxpayers. To simplify the system, the additional factors could be abolished and the marginal rates adjusted accordingly. For example, a new lower income tier above the tax-free threshold could be introduced at which neither the Medicare levy nor the low income tax offset needs to be factored in. Rather the income level and applicable rate could already take these factors into account.

In addition, the myriad of work-related expense deductions, which deepen the complexity associated with the taxation of individuals, could be substituted with a standard deduction amount. Examples of claims which may be made include for expenses such as home office expenses, telephone and internet usage and motor vehicle expenses, all of which generally have a private use component, which adds to the complexity.

The ATO has issued a raft of guidance on work-related expense deductions generally and for employees in specific industries to assist them to understand what they may be entitled to claim. The fact the ATO has to issue such guidance is evidence that the rules around deductibility of work-related expenses can be complex and are not easy to navigate by individual taxpayers without the assistance of a tax agent or intermediary.

i) Comparable jurisdictions

Certain comparable international jurisdictions operate more simple systems for individuals with simple tax affairs. We refer to the table in the *Australia's Future Tax System – Report to the Treasurer (Henry Review)* released in December 2009 for a summary of this comparison⁴.

For example, the UK operates a relatively simple self-assessment system where, broadly, tax is deducted from wages, pensions and savings⁵ at source similar in nature to a 'final withholding' tax. Only individuals who derive other types of income, such as untaxed income or taxable capital gains, or who fall into certain categories of taxpayer, are required to lodge a tax return, meaning that a significant body of taxpayers are relieved from the requirement to lodge⁶. Employment-related expenses may be claimed

⁴ See the table entitled Box A1-2: International comparison of deductions for WREs in Part 2 Vol 1 at p54 of the Henry Review

⁵ <https://www.gov.uk/self-assessment-tax-returns/overview>

⁶ <https://www.gov.uk/self-assessment-tax-returns/who-must-send-a-tax-return>

in limited circumstances dependent on whether the taxpayer's claim is for more or less than £2,500⁷.

New Zealand does not require individuals whose earnings are limited to salary, wages, dividends and interest income to lodge a tax return⁸. Nor does New Zealand allow deductions for work-related expenses incurred by employees. Other countries provide only very limited or narrow circumstances where work-related expenses can be claimed.

Both the UK and New Zealand systems offer forms of simple regimes for individuals. Australia could draw on elements of these countries' systems to model its own system for individuals.

ii) Standard deduction

The Henry Review found that the scope of work-related expenses in Australia is broad by comparison to other countries and consequently recommended the introduction of a standard deduction to cover the cost of work-related expenses (and the cost of managing personal tax affairs) with taxpayers afforded the choice to take the standard deduction or claim actual expenses where the claims exceed the standard deduction with full substantiation⁹.

The Tax Institute supports Recommendation 11 of the Henry Review and recommends that, as a first step towards simplification, the Government should consider introducing a standard deduction for work-related expenses, while retaining the ability to claim actual expenses with full substantiation above a nominated threshold. A change in this area will be significant for individual taxpayers and is a step in the direction towards alleviating the compliance burden for many individual taxpayers. This would also help simplify tax matters for many individuals.

To assist with administration, the standard deduction could be factored into the 'Tax Tables' the ATO issues that employers use to determine how much tax to withhold from salary and wages via the Pay As You Go Withholding system. Automatically factoring in the standard deduction to amounts of tax withheld from employees would help to alleviate the compliance burden for individuals, as well as for the administration.

The Tax Institute's view is that, in the short term, the introduction of a standard deduction would make it much simpler for employees to comply with their individual tax obligations. Employees with expenses above the standard deduction threshold should also be provided with the option to claim their actual expenses, properly substantiated, should they wish.

⁷ <https://www.gov.uk/tax-relief-for-employees/how-to-claim>; for claims under this amount, if you do not otherwise fill in a self-assessment tax return, a taxpayer may be able to make the claim by telephone or there is a simple 'P87' online form to claim tax relief; otherwise claims are made through the (relatively simple) self-assessment tax return form.

⁸ <http://www.ird.govt.nz/income-tax-individual/end-year/ir3/>

⁹ Refer to p56 and Recommendation 11 on p57 in Part 2 Vol 1.

Digitisation

The Tax Institute also encourages the continuing development and adoption of new technologies to help simplify administration issues in the tax system. Developments such as the improved use of pre-fill information, initiatives such as 'myTax' and the streamlining of whole-of-government initiatives such as Standard Business Reporting and the 'Single Touch Payroll' initiative noted above should be encouraged.

While these types of changes can significantly reduce the compliance burden for a majority of taxpayers in the long term and may well have the positive impact of increasing taxpayer engagement in the system, they need to be properly executed (which requires extensive consultation, user-testing and education of the taxpayer community as to the changes and intended benefits). This is to ensure that the compliance burden is actually reduced rather than resulting in one type of administrative burden being replaced by another. In addition, not all new systems are suitable for all types of taxpayers and as such, solutions would need to be tailored for different market segments.

Where taxpayers' interactions with the administration are more complex interactions, or where taxpayers prefer (or need) to use an agent or intermediary:

- Tax agent (and potentially ATO) efficiency would be enhanced by allowing the tax agent's tax lodgement and management software to interact directly with the ATO database. That is, a tax agent could have access to the data currently available across a variety of ATO systems (such as the Tax Agent Portal) with an appropriately authorised login to the tax agent's tax software being used. Viewing the ATO as a 'data warehouse' ultimately will reduce the ATO's need to maintain a public interface to its data because the commercial software providers will be able to integrate this into the tax agents' operational environment. This would demonstrate a move towards contemporary, real time online access to data held by the ATO about a taxpayer, consistent with the overall government objective of 'digital by default'.
- ATO systems should have the capability to recognise that a particular taxpayer may use different agents for different taxes or types of interactions (eg a separate agent for income tax and GST obligations). While the ATO can manage this at the moment, it is not a seamless process. It needs to be made seamless to increase efficiency and provide taxpayers with their choice of agent for different purposes.

Centralising administration

Many benefits would arise from the centralisation of tax collection across the Federal and State and Territory revenue systems. Businesses, for example, have numerous obligations to meet, ranging from a raft of Federal tax obligations, (eg income tax,

PAYG Withholding, FBT, GST etc) and may also have payroll tax obligations to meet in a number of States. Where businesses could remit all amounts to a central collection agency, this would reduce the overall compliance burden at both the Federal and State/Territory level, thereby likely contributing towards increasing engagement with the tax system.

In addition, there is the possibility that a centralised administration could issue rulings and interpretations on all revenue laws, thereby ensuring consistency in interpretation of tax and revenue concepts across multiple jurisdictions.

Educating Taxpayers

There would be merit in considering further the role the ATO could play in educating taxpayers (individuals and businesses) that are new to the tax system to assist them to understand their tax compliance obligations. It is recognised internationally that revenue authorities that are proactive in ensuring that new businesses are accurately recorded in the taxpayer register and understand their tax obligations from the outset are more likely to comply voluntarily¹⁰.

Conclusion

It is unlikely that the complexity issues in the tax system will be resolved in the immediate future. As noted above, we refer the Committee to The Tax Institute's 2017-18 Federal Budget submission¹¹.

As such, any future design of the tax system needs to ensure that the key role that tax agents and other intermediaries play in the system is taken into account and accordingly relevant recognition is provided to those intermediaries.

- The prevalence and impact of the 'cash economy' on the tax system, mechanisms to ensure tax compliance and strategies used by comparable countries' revenue authorities

The Tax Institute notes that the 'cash economy' is the subject of a separate inquiry being undertaken by the newly established 'Black Economy' Taskforce. In The Tax Institute's view, the cash economy is a consideration which is relevant to, but not entirely overlapping with, taxpayer engagement with the tax system, and we encourage the Committee to consider the findings of that taskforce in light of this.

We observe that the higher the compliance burden and the more difficult it is to comply with, the more likely it is that taxpayers will be inclined to avoid their tax compliance obligations. For example, an employer faced with paying a small amount of extra

¹⁰ See the *OECD: Right from the Start: Influencing the Compliance Environment, 2012*.

¹¹ <https://www.taxinstitute.com.au/tisubmission/federal-budget-submission-2017-18>

remuneration to an employee, and having to deal with workers' compensation¹², PAYG or FBT, and SGC may well decide to agree with the employee to pay cash in hand just to avoid the additional time and effort. Without commenting on the details of specific initiatives, the general ATO approach towards increased digitisation evidenced by initiatives such as myTax, 'Single Touch Payroll' and the 'myDeductions' App, is clearly beneficial to help ease the compliance burden somewhat and try to address this kind of situation.

It is well known that the Commissioner of Taxation's general power of administration empowers him to make pragmatic decisions about enforcement so as to maximise net revenue collections, rather than being statutorily obliged to chase every last dollar of possible tax. It is submitted that legislators and others involved in the tax system should take a similar approach.

For example, when considering any proposed introduction of a new compliance obligation to counter perceived tax evasion, policy makers should consider the extent to which the measure would impose additional burdens on the already law-abiding tax payers, the extent to which such extra burdens might actually act as an incentive to switch to the 'black' economy (see the example above concerning employment taxes and compliance burdens) as well as the extent to which they may be effective in catching existing cheats. The Explanatory Memoranda for tax Bills do generally include comments on compliance costs, but in some cases they seem to us to underestimate the transitional cost of advisers simply having to navigate their way through legislative changes to keep up to date, and the costs of analysing any change to determine its impact on existing practices and systems.

Evasion also reflects prevailing attitudes in the community, or sections of it. Generally, members of the public are more likely to engage in tax evasion if they think that others are doing so. Therefore, misleading exaggerations and outright falsehoods concerning alleged non-compliance by large taxpayers are extremely detrimental to the tax system in general. It is understood that government cannot prevent outsiders from misrepresenting government's statements on these matters (as happened, for example, with the ATO's 2014-15 Report of entity tax information, despite the ATO's commendably responsible approach to the production and release of that report), but the more that government can do to counteract such inflammatory misrepresentations the less detriment those distortions will cause to the tax system.

¹² State/Territory issues such as workers' compensation and payroll tax are presumably beyond the scope of this enquiry. Nevertheless, we note that State/Territory regulatory burdens are an important part of the overall environment in which businesses operate, and that the business environment will be improved by anything which can be done to achieve regulatory and administrative improvements in the State and Territories themselves, to alleviate multi-jurisdiction duplication of compliance burdens and to eliminate work-making inconsistencies between similar concepts (e.g. different definitions of remuneration for different tax purposes).

If you would like to discuss any of the above, please contact either me or Tax Counsel, Stephanie Caredes, on 02 8223 0059.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Matthew Pawson', with a long horizontal flourish extending to the right.

Matthew Pawson
President