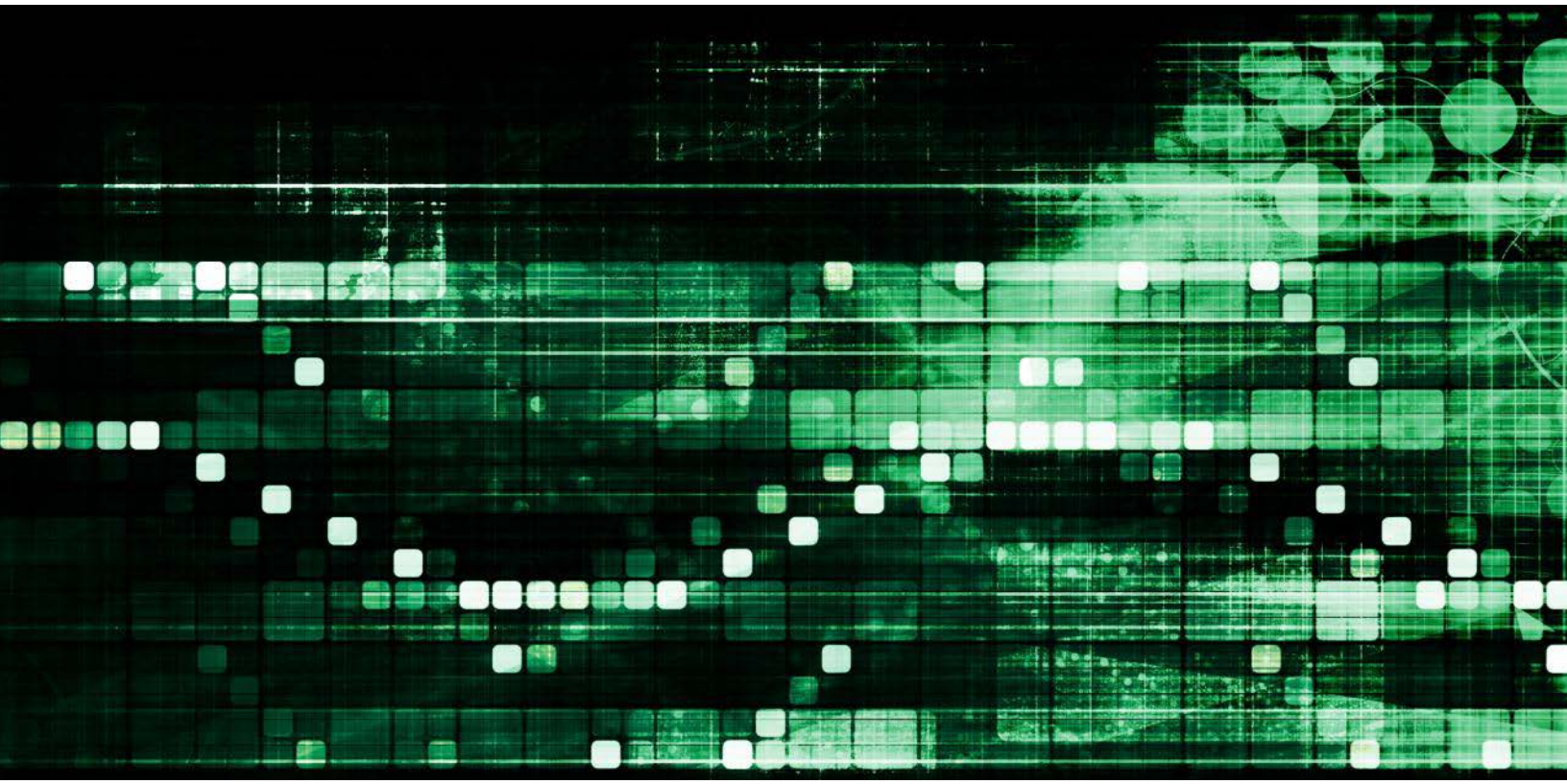
H&R BLOCK AUSTRALIA GREEN PAPER REPORT

MAY 27, 2015



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INTRODUCTION

H&R Block is Australia's largest firm of tax accountants. Operating from over 450 offices nationwide and preparing tax returns for over 750,000 people, H&R Block is responsible for preparing over 6% of the total number of individuals' tax returns submitted every year.

This scale and breadth gives H&R Block a unique insight in the operation of the tax system as it applies to individuals. Increasingly, we are helping small businesses too, aiding them to navigate their way around the challenges of the tax system.

Perhaps more than any other tax or accounting firm in Australia, we can claim to be truly in touch with the views of ordinary taxpayers.

It is notable that in many debates around our tax system – whether it be around the tax mix between income taxes and GST or the ongoing debate around tax avoidance by large companies – the voices of the everyday taxpayer are too often not heard.

We hear a lot from business, large and small, about what they want. We hear a lot from other voices in the tax and accounting profession. But the voices of those 13 million individual taxpayers, who make up the biggest part of our system, are often not heard as loudly.

This report aims to give those ordinary taxpayers a louder voice.

This report also aims to give voice to those tax practitioners who advise and assist them on a daily basis.

We thank the *Treasurer, the Rt Hon Joe Hockey MP,* for the opportunity to take part in this debate around tax reform. We welcome this review, which is well-timed to allow us to build a tax system fit for the rest of the 21st century.

In the pages following, we present our comments on the questions raised in the Re:think discussion paper, with a particular focus on the income tax system as it affects individual taxpayers. We also look beyond the Re:think paper to present some additional insights into the future of the tax system and the role of tax agents like H&R Block within it.

As the process continues, we hope that many of the ideas raised in this document will feed through into the government's program for reform and we look forward to working constructively with the government to build a future tax system for all Australians.

Chapter One

Executive Summary

In March 2015, the Australian Treasurer, the Rt Hon Joe Hockey MP, launched an in-depth review of the Australian tax system, with a view to making our taxes fairer, simpler and lower. As part of that process, the Treasurer issued a discussion paper (named "Re:think") asking a number of focussing questions and seeking community feedback on those questions and on the operation of the Australian tax system generally.

Our overriding philosophy is to act as the voice for those who might have no other input into this review, the millions of individuals who meet their obligations each year and whose voices are sometimes unheard by those who shape the tax system.

This report gives H&R Block's perspectives on the discussion topics for which public submissions were requested. The focus of this report is on easing the administrative tax burden for individuals, simplying some of the provisions, and clarifying areas of common taxpayer confusion. Therefore the majority of our perspectives are regarding the tax system as it applies to the everyday individuals who are typical clients of H&R Block.

We also comment extensively on matters affecting small businesses, many of which are also H&R Block clients.Recognising that a well administered tax system also requires a strong, independent, third-voice, we also seek to put the case for tax agents as a key part of the system, particularly those tax agents who help individuals and small business to navigate their way through the current tax minefield.

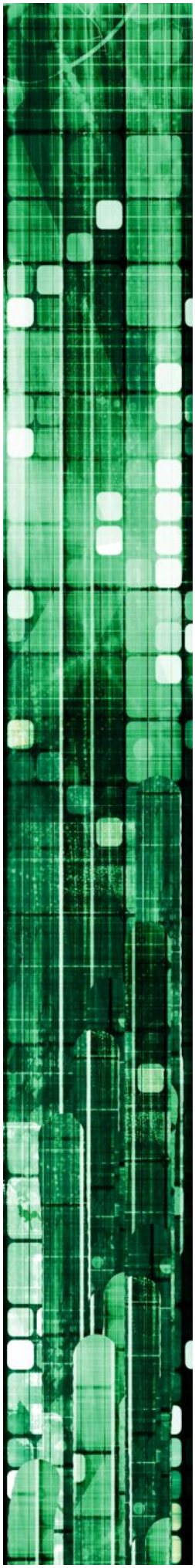
During the course of this submission, we set out a possible vision for the future of the tax agent. We also deal with many of the questions raised by the Treasurer as part of his Re:think process which particularly impact individuals and small business.

The primary issue facing our tax system is the compliance burden placed on the taxpaper and the confusion surrounding many of the provisions**.**

Whilst the mix of taxes between corporate and personal income taxes and consumption taxes, such as GST, is currently broadly appropriate, the system of laws surrounding those taxes badly needs to be steamlined and clarified in order to reduce compliance and administration costs and to boost economic activity.

The other part of the puzzle is to ensure that the tax system is fit for the purpose for which it is intended and that cannot be achieved by looking at the tax system in isolation.

We must consider big questions around the type of society we want, the extent of the services that our taxes are required to support and the role of government versus the role of private enterprise and civil society. That will produce a picture of the amount of revenue which government needs to raise and only then can we begin to think about questions, such as tax rates and the mix of taxes, all of which need to be calibrated to reach the desired revenue inputs.



To answer those big questions will require a larger exercise than this discussion paper. Nevertheless, this process represents a valuable start to the national conversation and accordingly we highlight below our 15 perspectives for change to the tax system. The final section of this paper provides more details on each of our specifics perspectives:

Perspective One:

Commit to simplifying the interpretation of Australian tax law by rewriting all current tax law into one volume written in "plain English". Establish the principles underpinning Australian tax law. Ensure that current and future tax law conforms to those principles.

Establish a new body charged with the role of overseeing the rewriting and simplification of tax law language, with substantial representation from community groups representing individuals and businesses.

Set a deadline for the rewrite and language simplification project and ensure that the job is completed.

Perspective Two:

The system for claiming self-education costs as a deduction could be broadened and simplified to allow costs related to career advancement to be claimed as tax deductible. The present link to current income earning activities could be substantially loosened.

The $250 limit set out in section 82A ITAA 1936 could be abolished to reduce complexity and confusion.

Perspective Three:

The current definition of residency for individuals could be simplified and clarified. The concept of domicile could be removed from the tax law.

Perspective Four:

Greater clarity is required around the $300 minor work expenses deduction. This could either be made a standard deduction for all or be abolished.

Perspective Five:

The law around travel, meals and motor vehicle usage could be simplified and rewritten. The multiple alternative bases for making claims could be replaced by one set of rules, which relies on substantiation.

Perspective Six:

Consideration should be given to abolishing all tax offsets and replacing them with an across the board increase in the tax free threshold, which would benefit all low income earners.

Perspective Seven:

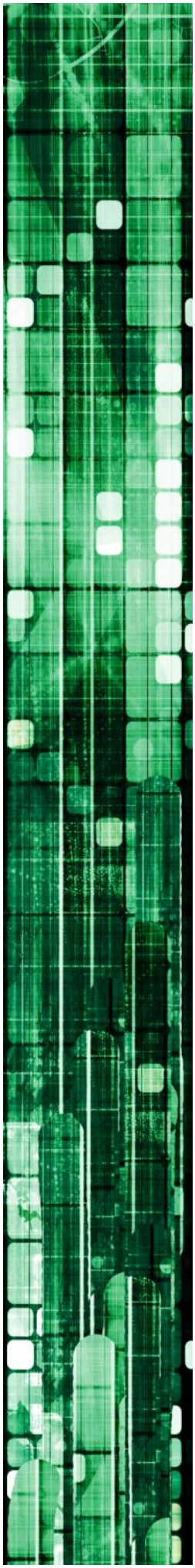
Making greater use of amnesties and voluntary disclosure initiatives can be effective as a strategy for re-engaging with non-compliant taxpayers.

Perspective Eight:

Introducing annual indexation of income tax thresholds could help mitigate bracket creep.

Perspective Nine:

The current system allowing employees to claim work-place deductions (and other deductions such as charitable donations and the cost of managing tax affairs) should be maintained in its current form. It is fair, easy to understand, sound from a policy perspective and popular with taxpayers.



Perspective Ten:

Review the FBT system, including studying the feasibility of abolishing FBT altogether and absorbing it into the income tax system, with benefits taxed at the employee rather than the employer level.

Perspective Eleven:

Consideration should be given to introducing more flexibility into the recoupment of tax losses, particularly for small businesses, by, for instance, the ability to carry losses back against previous years' profits.

Perspective Twelve:

Consideration should be given to an extensive review of the system of taxing employee share ownership to provide maximum flexibility for start-up businesses in particular to use shares as a tax effective incentive mechanism.

Perspective Thirteen:

We propose that consideration be given to a wholesale review of the small business CGT concessions to ensure that they are properly targeted, with clear criteria to qualify and framed by straightforward, easy to follow law.

Perspective Fourteen:

We propose that consideration be given to raising the GST registration threshold to a level commensurate with that required to exempt the smallest businesses from GST. Taking into account the declining value of money since the introduction of GST in 2000, a GST registration threshold of $150,000 may be appropriate.

In addition, or as an alternative, greater use could be made of annual (rather than quarterly or monthly) reporting to reduce the compliance burden on small business.

Perspective Fifteen:

All tax legislation should be implemented prospectively (not retrospectively) unless there is a clear threat to tax revenue which needs to be addressed.

All new tax proposals should be presented with draft legislation already drafted and with a clear timetable to implementation.

Chapter Two:

The Self-Assessment System

The basis of the Australian tax system is self-assessment. This means that tax returns lodged by taxpayers are accepted as being correct at the time of lodgement. It also means that the onus for the accuracy of the information in the return rests solely with the taxpayer. Accordingly, self-assessment relies on voluntary compliance by the taxpayer.

The ATO conducts a wide-ranging audit and review program to confirm the details disclosed in tax returns. However this occurs after the lodgement of the return and the payment of tax.

An assessment is issued on the basis of the return as lodged and the ATO has the right to scrutinise that assessment for up to four years after it has been issued. That period is reduced to two years for some categories of taxpayers, including most individual taxpayers.

Under self-assessment, it is assumed that taxpayers have the knowledge to accurately complete their returns and that they also have the necessary knowledge and understanding to apply the law to their circumstances.

From 1 March 2010, safe harbour provisions were introduced into tax law. These provisions arose as a result of the new tax agent services regime, which exempts taxpayers who utilise the services of a registered tax agent from liability for administrative penalties for certain mistakes and omissions where the error is solely due to the agent's mistake.

Self-assessment replaced the previous system of full assessment in 1986-87. Under the old system, each return was checked for accuracy by the ATO before they issued an assessment. Self-assessment therefore shifts much of the compliance burden – and particularly the burden for getting it right – from the ATO onto taxpayers. In addition, self-assessment has allowed the ATO to move resourcing away from the manual checking of returns towards investment in technology which can automatically spot inaccuracies and omissions. In other words, the ATO has moved towards a culture of risk assessment, review and audit.

Lodging Tax Returns

Each year, the Commissioner gives notice in a legislative instrument requiring taxpayers to lodge their income tax returns. Individual resident and non-resident taxpayers, whose income exceeds the tax free threshold (currently $18,200), must usually lodge by 31 October following the end of the relevant income year.

The broad scope of the lodgement criteria means that in practice, the majority of Australian resident individuals will need to lodge a return. This typically amounts to about 13 million individual returns out of a total national population of about 22 million.

A taxpayer may self-lodge using either e-tax or myTax, the ATO's free services for preparing and lodging a return electronically via software downloaded onto a computer.

MyTax was introduced in 2014 for taxpayers with simple tax affairs (typically, wages and salary, bank interest and dividends). It consists of only about 10 screens of information - a fraction of the input required to complete e-tax. About 4 million taxpayers were eligible to use it and about one million did so.

E-tax is the older self-lodgement system, which in theory can be used by anyone, but with the introduction of myTax, is now largely confined to those who do not meet the criteria for using myTax.

Both myTax and e-tax (but particularly myTax) make substantial use of pre-filled information downloaded into the return by the ATO from their own database. This information will in turn have been provided to the ATO by third parties, such as employers, banks and share registries.

Despite this reliance on pre-filled third party supplied data, the core of the self-assessment system—that it is the taxpayer who is ultimately responsible for the accuracy and completeness of the information in returns—remains intact. This has the potential to cause self-preparers to trip up by not fully checking the pre-filled data (some of which might be either wrong or missing[1]) and sending in a return, which may accordingly not be correct.

Returns lodged by registered tax agents are due progressively according to a lodgement program managed by the ATO.

Final dates for lodgement for tax agents are based on the client type, the lodgement program of the tax agent and the tax agent's performance in respect of on time lodgements. Agents generally receive a substantial extension of time compared to self-preparers, which means that taxpayers dealt with by tax agents can have up to May of the year following the end of the tax year, i.e., up to 8 months longer than self-preparers.

How Australians are Taxed

In essence, the way individuals are taxed is quite simple. They are liable to tax on their income, less any allowable deductions.

In reality, it's quite a bit more complicated than that. Even before we consider the question of what constitutes a deduction, it's necessary to decide what constitutes income.

Australian tax law splits the concept of income into two, being either income according to ordinary concepts or statutory income.

[1] Sampson, A. (2007, May 12). Pre-filled Tax Returns Still Need Checking. *Sydney Morning Herald*: <http://www.smh.com.au/news/business/prefilled-taxreturns-still-need-checking/2007/05/11/1178390553355.html>, as of December 8, 2010

Income according to ordinary concepts relates to all those things that most taxpayers would regard as income if they were to receive it.

Statutory income includes amounts that would not normally be regarded as income but are deemed to be so by the tax law.

Examples of the two types of income are set out in the table below:

Income According to Ordinary Concepts	Statutory Income
Salary and wages	Many types of allowances
Business and professional earnings	Employee share scheme benefits
Primary production income (from agriculture, fishing, forestry, etc.)	Dividend franking credits
Share of net income derived from a partnership	Net capital gains
Insurance receipts to replace loss of wages, profits and/or stock (included because the items the insurance proceeds have replaced would themselves have been assessable income)	Many types of allowances
Workers compensation	
Certain social security benefits	
Dividends	
Interest	
Rent	
Royalties	

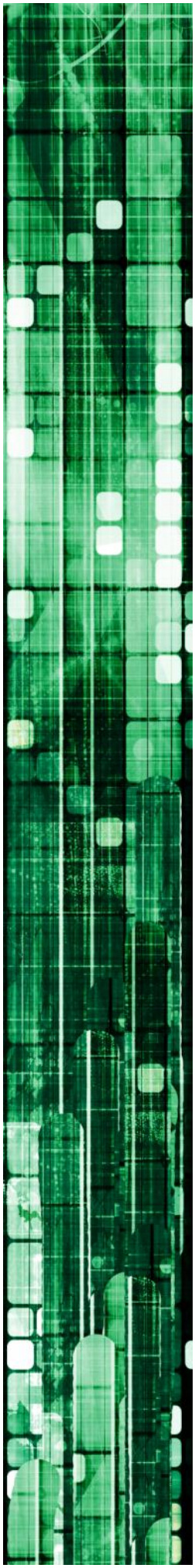
Some amounts which might be thought to be income, for example, gambling profits, are not taxable at all.

Income which is taxed as capital, and some other types of income, are taxed according to special rules beyond the scope of this report. We are focused primarily on ordinary income and that is what will primarily be discussed herein.

Having determined the amount and type of income received, the next step a taxpayer needs to undertake is to quantify the type and amount of deductions they are entitled to claim.

Allowable deductions include general deductions and specific deduction. General deductions are allowed under the wide-ranging provisions enacted in Section 8-1 Income Tax Assessment Act 1997, which allows:

- Expenses incurred in gaining or producing assessable income.



- Expenses necessarily incurred in carrying on a business for the purposes of gaining or producing assessable income.

Even if the expense appears to be allowable under one of these 'positive limbs', s8-1 denies a deduction if the amount is:

- Of a capital nature.
- Of a private or domestic nature.
- Incurred in deriving income which is not taxable.
- Non-deductible, according to a specific provision of the tax law.

Tax law also allows that a tax deduction can be claimed for certain 'specific deductions' that would not otherwise be allowable under s8-1. This includes:

- Capital allowance deductions.
- Claims for research and development expenditure.
- Investments in Australian films.
- Many others.

The excess of assessable income over allowable deductions is taxable income. If allowable deductions exceed assessable income, the result is a tax loss.

The amount of tax actually payable is arrived at by multiplying taxable income by the rates applicable at the time, as set out in the Tax Rates Act 1986.

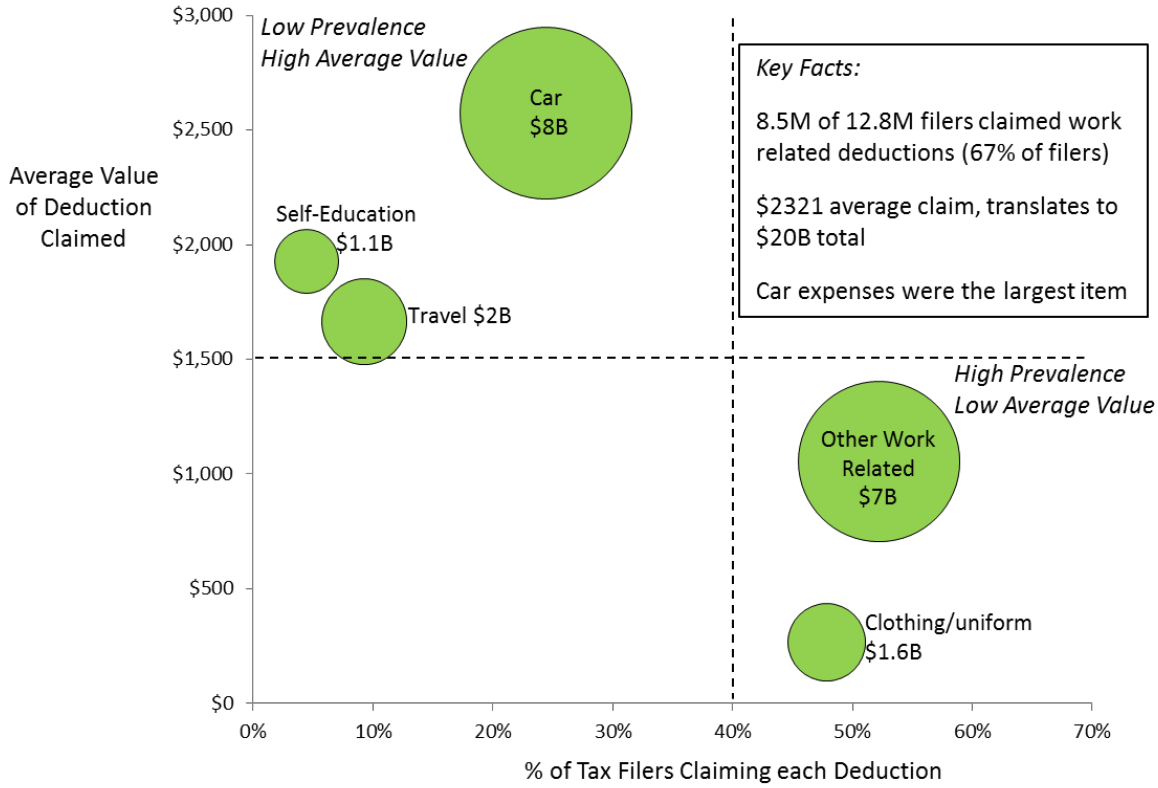
The sheer breadth of items which can be claimed by way of employment-related claims, is impressive. To give an indication of the type of items that can be claimed, see below:

- Vehicle and travel expenses – You can claim expenses directly related to your work, but not for travel between your home and work.
- Clothing, laundry, and dry cleaning expenses – You can claim the cost of buying and cleaning occupation specific clothing, including uniforms and protective clothing.
- Gifts and donations.
    - Home office expenses – Including the costs of a phone, computer, or other electronic device that you need to use from home, plus a portion of the running costs of your home attributable to your home office.
    - Interest, dividend, and other investment income deductions.
    - Self-education expenses, such as courses, seminars, or conferences related to your work.
    - Tools, equipment, and other assets.

- Other deductions. As a rule of thumb, if you need to spend money to earn income, you can usually claim it, either immediately or over time.

In the most recent year for which ATO statistics are available, the 2012/13 Tax Year, two thirds of Australia's 12.8M tax filers claimed work related deductions (8.5M individuals). The average value of these work related claims was $2321, translating to $20B in total deductions.

Exhibit: *Work-Related Tax Deductions: Prevalence and Value (2012/13 Tax Year, ATO)*

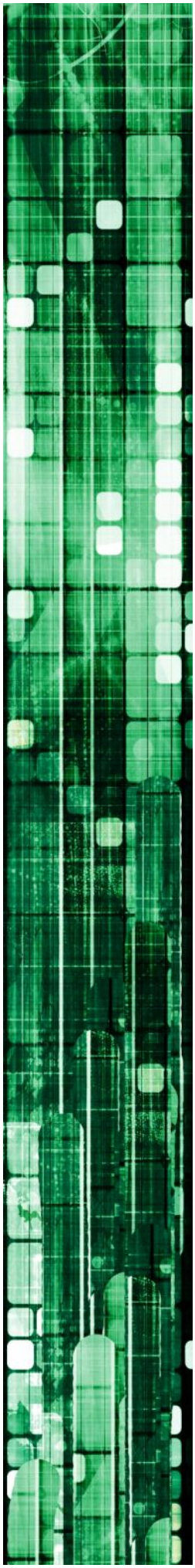


The ATO, Compliance and Enforcement

As noted earlier, the change to a self-assessment system fundamentally altered the relationship between the ATO and taxpayers. By shifting the burden of compliance onto individual taxpayers, the ATO was able to free up thousands of tax officers who up until that time had spent their entire working lives laboriously manually checking tax returns and then issuing assessments.

Now, it's the responsibility of the taxpayer to make sure that the information they are sending in is correct and in most cases, the ATO will undertake few if any manual checks on returns before issuing an assessment, based on the taxpayers figures.

What this means is that we now live in a tax culture based on risk assessment,review and audit.



The ATO now receives billions of items of data every year relating to Australian taxpayers. That includes not just the tax return itself but information provided by employers, banks, share registries, land registries and even car dealers. The ATO is therefore able to build up a complex and detailed picture of the everyday life and financial activities of taxpayers, just based on the information received from those third parties. This can be cross-referenced with the information provided by taxpayers themselves to highlight those taxpayers who—whether inadvertently or not—are not providing a full or accurate picture of their tax affairs in their tax return.

From here, the ATO is able to build a risk profile for every taxpayer and to model those taxpayers onto a risk model, which highlights those who require compliance action of some sort. In determining risk, the ATO looks at two factors: the first is the likelihood of risk posed by a taxpayer, broadly meaning the extent to which the ATO is aware of instances of non-compliance by that taxpayer (which can include failing to declare items of income, over-claiming expenses, failing to settle tax bills on time or simply failing to lodge a tax return at all); and the second is the consequence of non-compliance by that taxpayer. Quite simply this equates to the monetary risk posed by the taxpayer, the dollars at stake in relation to that individual or business. So, a taxpayer earning $10,000 per annum would be regarded as lower risk than one earning $1,000,000.

A sometimes used third component is the public profile of the taxpayer or the risk they represent to the integrity of the tax system. This means that certain categories of taxpayer are afforded closer scrutiny than others, with a particular focus on groups like politicians, senior legal figures, high-profile business figures and tax officers themselves.

The ATO plots all taxpayers onto a risk matrix, based on these overlapping risk factors and assigns each of them a score. Low risk taxpayers, who represent about 90% of the community, will in practice receive little if any attention from the ATO. Higher risk taxpayers (who typically represent no more than 1% of the total population) will be liable to review or audit based on the perceived risk which they represent.

So, for the average taxpayer, who fills in their fairly straight-forward tax return correctly every year, the amount of attention which they get from the ATO will be virtually nil.

If that taxpayer inadvertently fails to include an item of income, for instance, this will in all likelihood be picked up the ATO's sophisticated technology and they will find themselves subject to a review which will probably lead to them being issued with an amended assessment in the correct amounts.

Should the taxpayer demonstrate numerous errors or omissions in the information they return, and particularly if there appears to be evidence of deliberate or calculated malpractice on the part of the taxpayer, it is likely that they will be subject to a much more detailed audit of their tax affairs, including scrutiny of their books and records and demands for explanation around the tax decisions they have made.

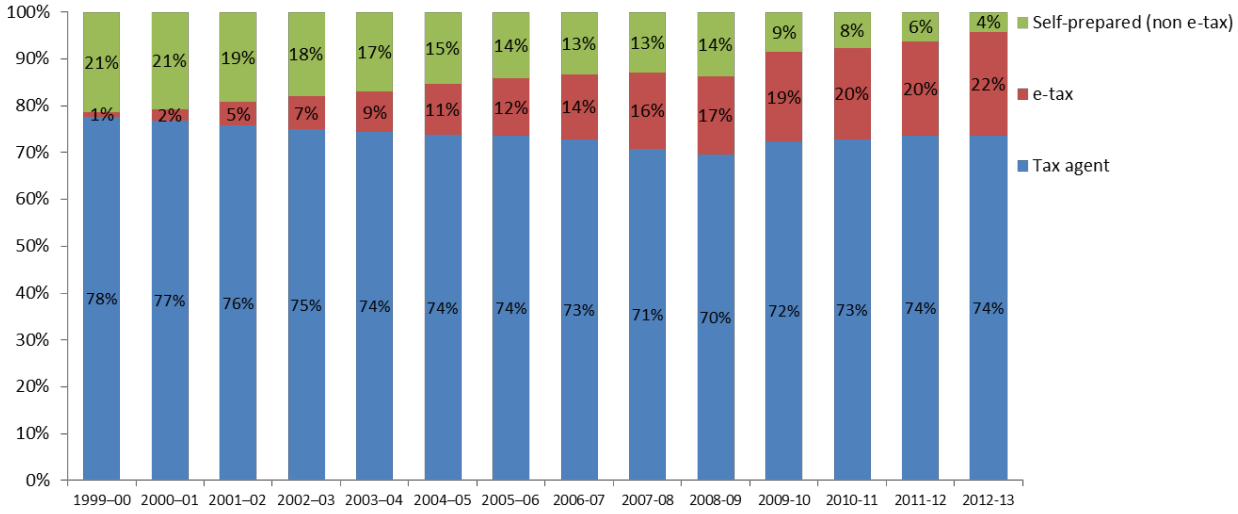
Having demonstrated that they are higher risk, this level of scrutiny may roll forward into future years, even though their behaviour may appear to be compliant in those later years.

Chapter Three:

The Case for Tax Agents

Australia has one of the highest rates of tax agent usage in the OECD, second only to Italy. More than 70% of Australian individual taxpayers use a tax agent to lodge their tax returns. Use of Tax Agents has declined slightly over the last decade and a half, however most of the migration has been from paper (TaxPack) self-preparation to electronic self-preparation (e-tax).

Exhibit: *Use of Tax Agent vs. Self Preparation 1999/00 to 2012/13*



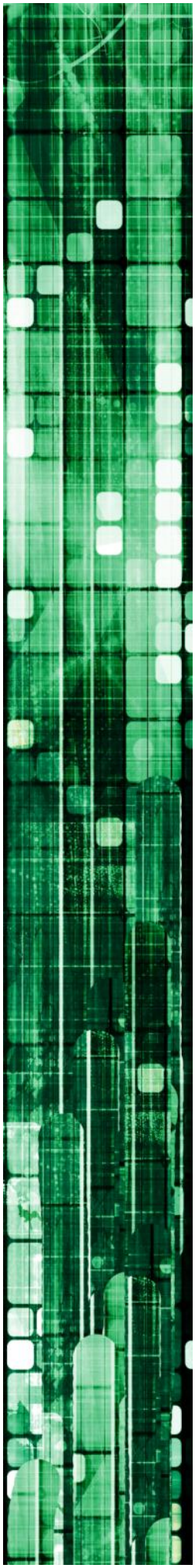
Source: ATO Taxation Statistics 2012/13

There are various factors driving this, not least the convenience of having a skilled professional handle a chore that few people are comfortable with, thus saving both time and stress to the individual taxpayer.

Underlying all of this, however, the key reason why so many of us choose to use a tax agent is the sheer complexity of the tax system, as noted in Chapter 10 of the Re:think discussion paper. With thousands of pages of tax law in existence, even a tax professional would struggle to understand all of it, so what hope would the average taxpayer have?

Of course, the average taxpayer doesn't need to concern themselves with the minutiae of most of the tax law. If you are a taxpayer with no income other than a salary and a little bank interest, for example, arguably you should be able to complete a tax return without professional assistance. But when that salary earner is confronted with the actual scope of the task—what deductions to claim, what offsets are available, etc.—it can quickly become too difficult.

Although the federal government's new myTax program, with its streamlined ten screens of information to complete, is a substantial improvement, the full online lodgement tool, e-tax, consists of over 100 screens of very complex questions. For most taxpayers, most of



those questions won't be applicable, but how does a taxpayer even know which questions to answer and which to ignore?

In some respects, the system has been designed to operate with tax agents as key players. The introduction of self-assessment in 1987 moved the compliance burden away from the ATO and on to the taxpayer. From that point, it became the responsibility of the taxpayer to ensure that what they are reporting is correct and complete. By contrast, the ATO is now in the position where it can assume the information it receives from a taxpayer is right and take enforcement action against the taxpayer if that proves to be incorrect, even if the error is inadvertent.

In the first instance, that can involve an intrusive, time consuming and stressful review or audit. Leading on from that, the taxpayer can find themselves burdened with interest charges and/or penalties of up to 75% of the amount of underpaid tax. In severe cases, they can even face prosecution, bankruptcy or a prohibition on leaving the country.

All of that puts a premium on certainty and comfort for most taxpayers and the only way they can achieve that is to call on the services of a professional tax adviser.

The tax agent will understand a client's circumstances, will understand the way the law applies to those circumstances and will ensure that the client discloses both the correct income and the correct deductions. The agent will do that in a timely manner, obtaining the information he/she needs from the taxpayer and thereafter minimizing the taxpayers' own involvement in the process.

Little wonder that faced with the option of navigating the tax minefield alone or doing it in the company of an experienced guide, most people choose the latter.

But times are changing. The ATO has upped its game in the services that it offers to those who are now prepared to look after their own tax returns.

Technology has allowed the development of relatively easy to use, internet based tax return lodgement software, which is specifically designed to guide the taxpayer through the maze. Pre-filling from third party data has reduced the burden on taxpayers to have all the material they need at their fingertips. The internet has allowed the ATO to generate thousands of pages of easy to read guidance material to assist taxpayers who have difficulties.

So does this mean the end of the tax agent?

In some respects, the signs aren't promising for tax agents. Irrespective of what the ATO is doing, the tax agent market is suffering a demographic crisis. The days of individual suburban tax agents serving their neighbourhood seem to be coming to an end as large numbers of agents reach the end of the their working life. The typical profile of a tax agent is male and over 55 and clearly, if they aren't retired yet, many of them will be looking to retire in the next five years or so.

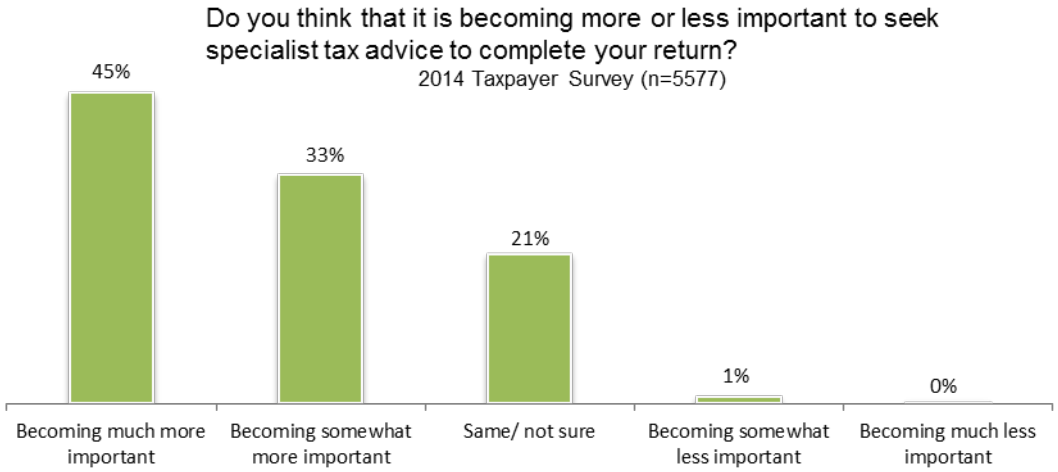
The growth of the ATO's self-lodgement system is also likely to have an impact, luring some taxpayers away from the services of an agent by the promise of an easy experience and a fee saved.

But all of that is too simplistic an analysis. Yes, there will be change in the tax agent marketplace but it will be evolutionary rather than revolutionary and the market itself will survive. H&R Block, which has been serving Australian taxpayers for over 40 years throughout numerous fundamental changes to the system – including the move from full assessment to self assessment – is an example of how a professional firm can evolve it's business model and service culture to reflect the needs of consumers.

The work that tax agents do, the way in which they will do it and the business models which they follow, will eventually change, but there will still be a demand for tax agent services, even if those services are different to what's currently on offer.

In fact, our 2014 survey of over 5000 taxpayers found that 78% thought that it was becoming more important to seek specialist tax advice.

Exhibit: *Importance of Tax Advice - H&R Block Taxpayers Survey 2014*



Whilst not all agents are either as technically accomplished or as efficient as their clients and the ATO would like, the fact remains that the best tax agents act in the best interests of their clients.

They work to secure the best outcomes for their clients and keep them out of trouble by making sure that they are well advised as to the operation of the tax law and that they are treated properly.

This latter point is important. The ATO doesn't write the law; it's role is to interpret and administer the law. Because the ATO states a position around the application of the law, there is no automatic presumption that what they have said is correct.

Tax agents provide a vital check on this aspect of the ATO. They provide an independent source of information and advice as to the operation of the law, which means that taxpayers need not only rely on the ATO but can also seek out a considered, well analysed

and impartial understanding of the way the law operates around their affairs. In a nation where a system of checks and balances is vital to the operation of daily life, tax agents provide that role within the tax system.

Taking the Burden off the ATO

The original driver of self-assessment was to reduce the administrative burden on the ATO by passing much of the responsibility for compliance away from the tax administrator and onto the taxpayer, which in practice often means the tax agent.

The forces that lead to that change have in no way abated in the intervening years. If anything, they have become more pronounced.

We now live in an era where they ATO is severely resource constrained. In the last year or so, some 3,000 tax officers have left the ATO, either due to voluntary redundancy or early retirement. A further 1,700 more are expected to go over the next year[2].

This means that out of an original workforce of about 22,000, over 20% will have left over an approximate three-year period.

The ATO argues that the increased use of sophisticated risk analysis and data matching technology means that they no longer need such a large workforce and that these cuts can be absorbed without impacting the ATO's core purpose—the collection of revenue. This is particularly important in these straitened times, when the ATO is under unprecedented pressure to collect revenue to fill the hole in the federal government's current and future budgets.

From the point of view of the tax administrator, that may be true but what does that mean for the taxpayer experience going forward? In practice, it may mean more pressure on the taxpayer to bear the burden of compliance, and that in turn is likely to feed into increased demand for tax agent services.

3 See "Blood letting at the tax office takes hold" by Noel Towell and Nassim Khadem, January 17 2015, at http://www.smh.com.au/business/blood-letting-at-tax-office-takes-hold-20150116-12f2kc.html

Amongst the ways in which this resource pressure could manifest itself in a worst case scenario include:

- Information on the ATO website becomes increasingly difficult to find, poorly written and out of date. Taxpayers find to their cost that they cannot rely on it—and in some cases cannot even find it—and choose to seek professional help instead.
- ATO service standards in dealing with taxpayer enquiries slip, meaning that phone calls to the ATO go unanswered or into a long queue. Responses, when they come, are perfunctory or simply wrong. Time poor taxpayers prefer to let a tax professional either deal with the query without going to the ATO or to handle the ATO relationship on their behalf.
- ATO technology systems become increasingly prone to temporary failure. Taxpayers are not prepared to trust the technology so use tax agents to do the work on their behalf.

In short, our belief is that the ATO needs a large, well-regulated, and engaged population of tax advisers to assist in the administration of the tax system. Taxpayers are not capable of doing much of this work, and the ATO is no longer resourced to do all of it. That means that over the longer term, the role of the tax agent will remain crucial to the effective running of the system.

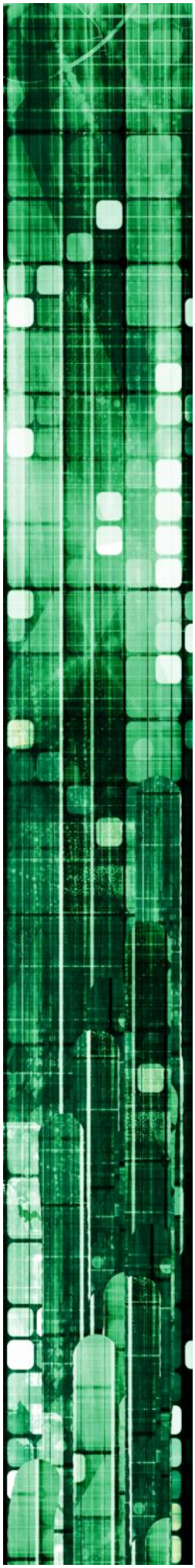
Tax Agents as Auditors

In the accounting profession, the term auditor has a very clear meaning linked to the sign-off of company accounts. But in general usage, the term has a much broader meaning and this could increasingly become a function of tax agents in relation to their management of the personal tax affairs of their clients.

With the ATO increasingly reliant on third party information to pre-fill tax returns, there are increasing risks that even self-lodgers will miss something when they complete their returns. Either the pre-filled information could be wrong or it could be missing altogether, a particular risk for those who choose to lodge early.

With the ATO increasing its use of third party data to cover items like capital gains on share disposals, there are risks that the information which it provides to taxpayers is not reliable. It would, after all, be a brave taxpayer who accepted the ATO's CGT calculation arising on a complex series of share disposals without getting the calculation independently verified by a qualified professional, based on the original source documentation provided by the taxpayer.

In relation to all of these new initiatives, the ATO is claiming to make life simpler for taxpayers. That could be right but they are doing so at no risk to themselves. Any errors or omissions, which can be traced back to the ATO, will not be the responsibility of the ATO because under self-assessment, it is the taxpayer's responsibility to ensure that information provided to the ATO in a return is complete and accurate, even if the source for that



information is the ATO itself. The ATO effectively washes its hands of the information it provides—the ultimate example of "buyer beware".

So, even if the amount of basic tax compliance and raw number crunching done by tax agents diminishes, the amount of verification work done by tax agents is likely to increase considerably.

And where information is lodged with the ATO and it turns out not to be correct and/or complete, the ATO is likely to pursue the taxpayer in the form of either a review or audit. Here too taxpayers will require professional assistance and as a consequence, tax controversy and dispute issues are likely to become an increasingly significant part of the workload of many tax agents.

The ATO is pushing tax compliance in this direction. Its ability to data-match will throw up increasing numbers of mis-matches between taxpayer and third-party information and the ATO is increasingly moving towards compliance action, focussed on resolving these mis-matches. There is a real question mark over whether the ATO is sufficiently resourced to do so, as its audit areas have been amongst the hardest hit in the recent rounds of job losses, so there is a significant possibility that some of this basic audit work could actually be subcontracted out to tax agents themselves.

That idea might seem fanciful but it is already happening, at least in relation to large businesses. The so-called External Compliance Assurance Program (ECAP) has been in a pilot phase for several months in relation to large businesses and allows the ATO to subcontract out certain basic audit functions (including the collection of information) from tax office audit staff to the clients' own advisers. It has been a major bone of contention that such a facility is only available to the "top end of town", but it certainly isn't too much of a stretch to see how such a program might also be rolled out to tax agents dealing with smaller businesses and even individuals, possibly by creating a panel of "trusted" tax agents who are entrusted to do this work on behalf of the ATO.

To summarise, tax agents:

- Are essential defenders of taxpayers' rights.
- Ensure compliance with taxpayers' obligations.
- Are key interpreters of the law
- Provide an impartial and independent view of the law and of tax administration.
- Reduce administration costs for the ATO.
- Provide peace of mind for taxpayers.

The system would be fundamentally weaker without tax agents. Taxpayers would be undefended and open to abuse by an administrator acting without check. Costs for both taxpayers and the ATO would ultimately rise and the system would operate less efficiently and less effectively. Our tax system would be fundamentally weakened.

Chapter Four:

Re:thinking the Tax System

Introduction

In this section, we turn to the questions asked by Treasury in the Re:think tax discussion paper and give our perspectives on the issues raised by that paper.

Re:think question 1: Can we address the challenges that our tax system faces by refining our current tax system? Alternatively, is more fundamental change required, and what might this look like?

The primary issue facing our tax system is complexity.

We believe that the mix of taxes between corporate and personal income taxes and consumption taxes, such as GST, is currently broadly appropriate but that the system of laws surrounding those taxes badly needs to be steamlined and clarified in order to reduce compliance and administration costs and to boost economic activity.

The other part of the puzzle is to ensure that the tax system is fit for the purpose for which it is intended and that cannot be achieved by looking at the tax system in isolation.

We must consider big questions around the type of society we want, the extent of the services that our taxes are required to support and the role of government versus the role of private enterprise and civil society. That will produce a picture of the amount of revenue which government needs to raise and only then can we begin to think about questions, such as tax rates and the mix of taxes, all of which need to be calibrated to reach the desired revenue inputs.

This review should not happen in isolation from that "bigger picture" conversation, otherwise the outcomes may not be optimal or sustainable for the long term.

Re:think question 2: How important is it to reform taxes to boost economic growth? What trade-offs need to be considered?

A more efficient and fairer tax system will almost certainly boost economic activity over the long run.

If the tax laws are clear and seen to operate fairly across all sectors of society, this will boost voluntary compliance and voluntary participation. Economic activity in the black or cash economy will decline. In addition, if the tax burden is fairly shared (particularly so that the largest businesses are seen to be contributing on a level playing field with individuals and small business), this will boost the number of small businesses and their profitability, as they are able to compete more effectively against the largest players.

Re:think question 4: To what extent should reducing complexity be a priority for tax reform?

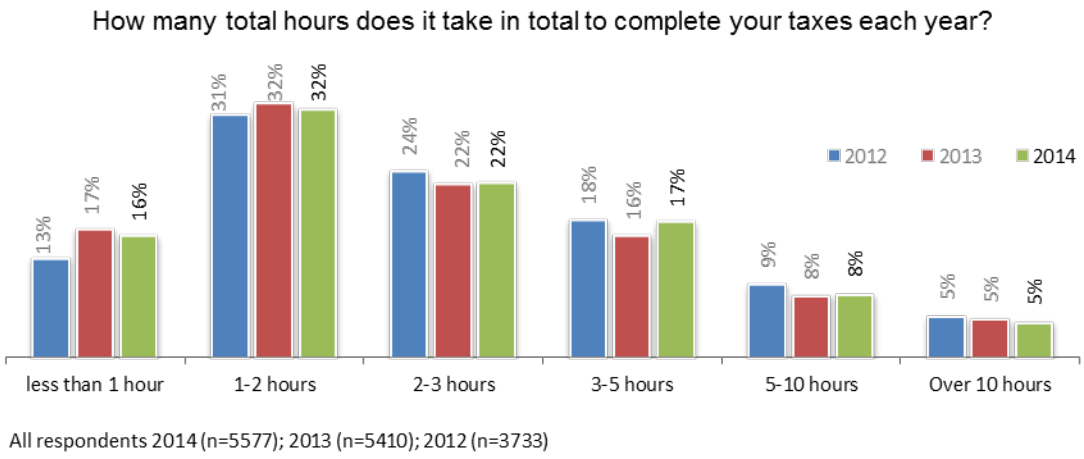
In our view, the key priority for this process is to reduce the tax administrative burden on the taxpayer and bring greater clarity and understanding of the tax provisions.

The income tax legislation alone extends to four volumes with over 10,000 pages of law. That just relates to federal taxes, without even touching the myriad state taxes. It also doesn't include GST, which is an additional volume.

If you are an individual or a small business, how is it possible to get your head around all that? The answer is that you can't, so you pay someone who can - an accountant, a tax agent, maybe a lawyer. Typically, they don't understand it all either, hence the legion of additional books interpreting and simplifying the law for professionals to then use when they deal with their clients. Quite simply, even the largest human brain can't hope to be familiar with and to fully understand each and every page of the voluminous legal pile that is Australian tax law.

Based on our 2014 Taxpayer Survey findings, it took most taxpayers 1-3 hours in total to complete their tax return. But for 30%, that time commitment blows out to over 3 hours.

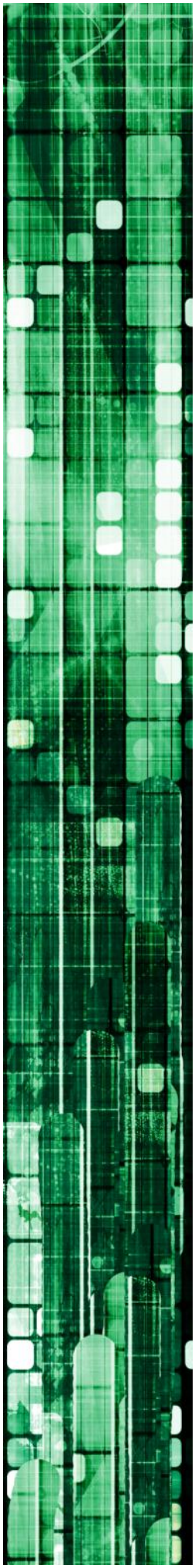
Exhibit: *Total Time Taken to Complete Tax Return - 2014 Taxpayer Survey*



All respondents 2014 (n=5577); 2013 (n=5410); 2012 (n=3733)

Back in the 1990s, the government set out to simplify the law, rewriting it in something called "plain English". That project ran out of steam and appears to have been abandoned. So now, instead of one main tax act, we have two. The original one from 1936, which is written in dense legal English and is totally impenetrable to an ordinary taxpayer, and a later one in 1997, supposedly written in "plain English" but not noticeably easier to follow than the 1936 act. And to understand how the tax system works, it is routinely necessary to switch between the two acts, from 1936 to 1997, and back again.

In addition, there are a myriad supplementary acts and also rulings and determinations from the ATO to clarify the way the law is supposed to operate, because even the ATO accepts that the law is frequently obscure and badly worded.



We believe there has to be an easier way. We understand that the world is a complex place and that the economic relationships which bind us all together become ever more creative in their structuring. But tax doesn't need to be like that. All that complexity can be narrowed down to a few core principles which delineate the way we tax income, the way we tax capital, the way we tax consumption, the deductions we allow and the way we treat losses.

The benefits to the Australian economy from having tax laws which don't require a Masters of Law to navigate are potentially huge. A key goal of this review should be on framing the rules in a straightforward, easy to follow form, using language that anyone can understand. Focus on the core principles, setting a target for shrinking the mountain of law to say one volume. At the very least, complete the job started in the 1990s by integrating and rewriting the 1936 ITAA into the 1997 one. Better still, take a chainsaw to both volumes, setting out tax law in terms of principles and economic outcomes, moving away from the sort of highly detailed, black letter law which has been the hallmark of the system so far.

Perspective One:

Commit to simplifying Australian tax law by rewriting all current tax law into one volume written in "plain English". Establish the principles underpinning Australian tax law. Ensure that current and future tax law conforms to those principles.

Establish a new body charged with the role of overseeing the rewriting and simplification of tax law, with substantial representation from community groups representing individuals and businesses.

Set a deadline for the rewrite and simplification project and ensure that the job is completed.

Tax Reform for individuals: making life easier for the many, not the few

Much of the tax reform debate has centred on topics which will ultimately benefit a relatively small number of taxpayers, often large corporates whose agenda is actively pushed by large accounting firms like PwC and KPMG.

But the largest group of taxpayers are individuals, normal mums, dads, brothers and sisters who meet all their tax obligations when they are obliged to, don't break the rules but still get penalised by the sheer complexity of the system - a level of complexity that they simply cannot grapple with.

Most clients of H&R Block come to see us because of their interaction with the income tax system. That might be because they need to lodge their tax return or it might because they want clarity around how the income tax law applies to them.

We therefore wish to comment extensively on the income tax system as it applies to individuals and some of our comments will go beyond the scope of specific questions asked in the discussion paper.

In this section, therefore, H&R Block will canvas the kinds of reforms which will really make a difference to the 13 million or so individual taxpayers.

Based on interviews with senior H&R Block staff, who come into contact with taxpayers every day, this section will highlight some of the surprisingly simple solutions which can be implemented to produce real cost savings and a real reduction in the complexity of the system.

Self-Education Expenses

A better educated society is a more prosperous society and a more prosperous society pays more tax. The role of self-education in building that society is crucial and accordingly, we believe that the criteria for claiming self-education expenses should be simplified and widened. The focus on the nexus between self-education and current income earning activities is too narrow and should be broadened to allow a wider variety of career related training. For example, why shouldn't the tax system encourage a vet nurse to train to become a vet, or a nurse to become a doctor or a pharmacy assistant to become a pharmacist? None of this would be permitted under the current rules but the examples quoted clearly fit with the intent behind self-education as well as helping to build that better educated, more prosperous society.

Whilst the tax deductibility of self-education expenses is a cornerstone of our deductions system and should be substantially retained, the $250 limit set out in section 82A ITAA 1936 should be abolished. It adds a unique layer of complexity to an otherwise fairly straightforward area of the system. It is impossible to see the justification for this provision from a tax policy perspective (quite simply: what is the point of this section?) and abolishing it should have minimal revenue impacts, whilst substantially simplifying this aspect of the system.

Perspective Two:

The system for claiming self-education costs as a deduction could be broadened and simplified to allow costs related to career advancement to be claimed as tax deductible. The present link to current income earning activities could be substantially loosened.

The $250 limit set out in section 82A ITAA 1936 could be abolished to reduce complexity and confusion.

Residency

The current residency tests are too complex and should be simplified to a clear, easy to understand test. In particular, the outdated concept of domicile is too nebulous and subjective and should be removed from the residency test, in favour of fixed definitions around what constitutes residency, which cannot be easily misinterpreted by either the taxpayer or the ATO.

We note that different government departments frequently take differing and contradictory views on the residence of individual taxpayers. We have seen examples where the ATO deems an individual resident. whilst Medicare deem them to be non-resident. The residency

test should be standard across government so that a tax judgment that an individual is resident is automatically applied across all other government departments.

The current tax return should have a section which allows taxpayers to clearly indicate that they are a temporary resident of Australia.

Perspective Three:

The current definition of residency for individuals could be simplified and clarified. The concept of domicile should be removed from the tax law.

Minor Work Expenses ($300 threshold)

It is difficult to see the point for the continuation of this deduction. Many taxpayers wrongly assume that this is a standard deduction and automatically claim it, regardless of whether they have actually incurred the expenditure or not. One of two things should happen. It could be made a standard deduction so that all taxpayers can claim it with the confidence that the ATO will not pick them up for compliance action; or it could be abolished altogether so that it is clear that all work place deductions need to be substantiated.

Perspective Four:

Greater clarity is required around the $300 minor work expenses deduction. This could either be made a standard deduction for all or be abolished.

Allowances and deductions for travel, meals and motor vehicle usage

This is an area of great complexity that affects a large number of taxpayers. Many taxpayers are reviewed or audited by the ATO in this area because there are so many – mostly inadvertent – mistakes around what taxpayers can and cannot claim.

As an organisation, H&R Block sees numerous instances where taxpayers have tried to follow the law by, for example, claiming the ATO's acceptable daily rates for long distance truck drivers, only to be picked for compliance action by the ATO because employers actually pay much lower daily allowances. This is an example of the system being applied in a way that was never intended, such that parsimonious employers are encouraged to behave poorly, hard-working employees are penalised and ATO resources are wasted on compliance action that should never have been undertaken.

In relation to motor vehicles, the excessive complexity of the system is demonstrated by the availability of so many alternative ways of claiming for business use of a vehicle (though we note and welcome the recent simplification in Budget 2015 whereby two little used methods of calculating car allowances were abolished) and, indeed, two different categories of motor vehicle, one covering vehicles of more than one tonne and one less than one tonne. Different rules also exist, depending on whether the vehicle has been used for more or less than 5,000 business kms.

We propose that a standard rule should be adopted that all vehicle travel should only be claimable where substantiation exists, including recording of kms travelled. With

improvements in technology, it should now be possible for journeys to be clearly and simply recorded via electronic means, without imposing a substantial reporting burden on the driver or, where different, the owner.

The law for the payment and treatment of travel, meal and accommodation expenses should be rewritten to be clear, logical and fair. Crucially, it should also be understandable to all taxpayers—employees and employers—without the need for recourse to professional help.

Perspective Five:

The law for travel, meals and motor vehicle usage could be simplified and rewritten. The multiple alternative bases for making claims could be replaced by one set of rules which relies on substantiation.

Tax Offsets

Another area that causes large amounts of confusion is the system of tax offsets, including the seniors' and pensioners' tax offset (SAPTO), the low income tax offset (LITO), the dependent (invalid and carer) tax offset and the zone tax offset. The extreme complexity of these offsets – both in understanding to whom they apply, in what circumstances, and calculating their numerical impact – is particularly troublesome given that they typically apply to some of society's most vulnerable people, who are least equipped to deal with this degree of complexity without professional help, which they can ill-afford.

These offsets are often poorly targeted, such that people with no taxable income fail to benefit at all.

Perspective Six:

Consideration should be given to abolishing all such offsets and replacing them with an across the board increase in the tax free threshold, which would benefit all low income earners.

Amnesties and Voluntary Disclosure Initiatives

Whilst not strictly a policy question, we note that the ATO has had some success using an amnesty system to encourage those with undeclared offshore income to voluntarily disclose.

We believe that lessons can be learnt from this initiative and that similar schemes can be run in relation to other groups which are not fully participating in the system.

One example would be non-lodgers of tax returns and BAS forms. An amnesty would afford many of these non-lodgers, many of whom remain non-lodgers out of fear of the consequences when they finally do re-enter the system, with an opportunity to re-engage with the ATO on the basis that they will not suffer punitive consequences. The benefits of then having them fully back within the system in terms of additional revenue and reduced administrative costs will, we believe, greatly outweigh the costs in potential lost interest and

penalties.

Another group who would benefit from such a strategy (which will no doubt overlap with the first group) would be participants in the cash economy, who are failing to correctly account for all their business activities. Again, the benefits of bringing these people into the system would, we believe, outweigh the short term loss of revenue from previous unreported income.

Perspective Seven:

Making greater use of amnesties and voluntary disclosure initiatives can be effective as a strategy for re-engaging with non-compliant taxpayers.

Bracket Creep

One of the key issues with the current tax system is the fixed nature of the various income tax brackets.

The effect of this is that, without adjustment to either the tax rate or the bracket thresholds, increasing earnings move more people every year into one of the higher income tax brackets.

For governments, this can be very desirable. It acts as a tax increase "by stealth" and over time can lead to substantial inflows of revenue. For taxpayers, it is undoubtedly a bad thing since it can act as a disincentive to salary advancement.

The answer – rather than the current favoured solution, which is periodic cuts in the rate of income tax – appears obvious. Each of the tax brackets, including the tax free threshold, should be indexed by some measure of average earnings, so that every year without fail the various thresholds automatically increase in line with earnings. That way, there is no disincentive to advancement for individuals and nor is there a perceived tax grab every year by government.

Perspective Eight:

Introducing annual indexation of income tax thresholds can help to mitigate bracket creep.

Re:think question 15: To what extent do our arrangements for work-related expense deductions strike the right balance between simplicity and fairness? What could be done to improve this?

This is an area of serious concern to H&R Block clients.

Personal income tax payers have been able to claim deductions for work related expenses ever since the first income tax assessment act was enacted in 1915. Reading the literature, it can often feel like people have been campaigning to abolish them for almost as long.

Politicians, economists, tax academics and tax advocates have played out for many years a very public debate about this aspect of the system. Behind the scenes, generations of senior ATO officials have railed against workplace deductions as a blocker in their attempts

to move towards a UK or New Zealand style system, where for most taxpayers a tax return is simply not necessary because the tax administrator has enough information to calculate almost to the cent what a taxpayer's liability totals - something rendered impossible by the variability and unpredictability thrown into the system by the law around tax deductions.

It is important that the very sound tax policy rationale for allowing work-place deductions is not side-tracked by other issues around the simplification of the tax administration system.

That policy rationale was set out by Ken Henry as part of his 2008 review of the tax system, in which he said:

"Deductions are consistent with the Schanz-Haig-Simons definition of income, under which income represents the increase in a person's stock of assets in a period, plus their consumption in the period (with consumption including expenditure other than that incurred in producing income). There are important equity reasons for maintaining this approach; that is, it is fair to recognise that people with the same level of income may incur different costs in earning that income."

Mr Henry continued: "Earned income subject to taxation should be net of the costs directly incurred in earning that income. Work-related expenses should be clearly defined as those that are necessary to produce income."

This policy rationale is often attacked by tax policy experts, often claiming that removing workplace deductions will both simplify the system and raise additional revenue.

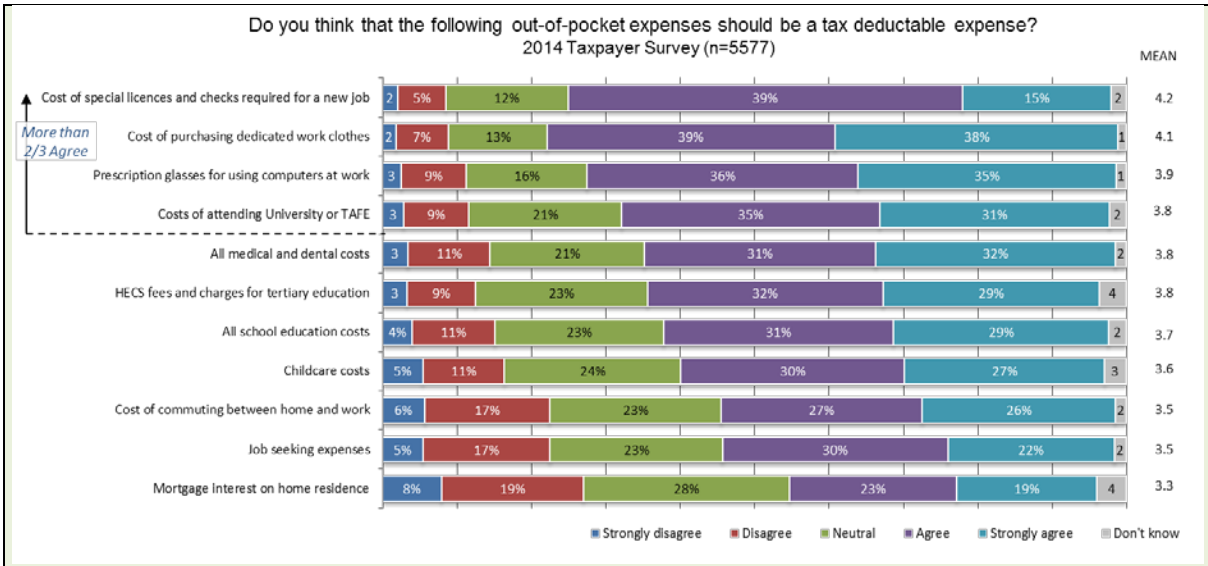
We do not accept that the evidence supports such claims.

One of the key reasons why the system of work place deductions has remained unchanged is, quite simply, that the system is popular.

Yes, it involves the taxpayer in some additional work in order to make the claims but the majority of taxpayers believe that they should be entitled to claim both their workplace deductions and the cost of managing their tax affairs against taxable income.

Our survey findings show that the majority of respondants supported broadening deductions in specific areas. In fact two thirds or more thought that deductions should be allowed for the cost of specials licenses/checks for a new job, dedicated work clothing, prescription glasses, and tertiary education.

Exhibit: Which Out-Of-Pocket Expenses should be Tax Deductible



Surveys have shown time after time that any proposal to remove these entitlements would be met with hostility by the taxpaying public, even if – as seems likely – the pill is sweetened with some sort of incentive - perhaps by a cut in the headline rate of income tax, or an increase in the tax thresholds.

Every year under the current system, Australians claim tax relief for those expenses, which they genuinely believe are required in order for them to make a living. Whether it be the cost of improving their skills in order to do their job better, the cost of the home computer which they need to deal with emails after hours or the cost of the safety vest they are required to wear in order to avoid injury, most Australians would baulk at the prospect that from now on, that will be their liability and their liability alone.

Passing the burden: the cost to employers

A commonly expressed reservation by many focusses on the importance of work related deductions to many middle income wage-earners, particularly in the public sector and the fear that the abolition of deductions will feed through into significantly increased pay claims or higher expenses claims to government departments.

In addition, it is highly unlikely that those who actually require the items they claim as part of their day to day work would go without. In many cases, the law – often health and safety law – would simply prevent this happening. The practical consequence is that costs would be shifted form the taxpayer to the employer, hence increasing business costs in a way which would most severely impact small business.

Saving revenue for government: dispelling the myth

Underpinning the debate about the abolition of work related deductions is the view that it's a guaranteed revenue raiser for the government and will lead to efficiencies within the ATO.

This is arrived at by simply looking at the amount of tax leakage which arises through workplace deductions and removing it. In terms of the ATO, it pre-supposes a freeing up of resources which can then be reallocated to other work, possibly enhanced amounts of audit

and review work.

But in reality – as the Rudd government found with its ill-fated proposal for a $500 standard deduction a few years ago – the only way this proposal can be made to work from a political perspective is by minimising the number of losers. In the Rudd case, the proposal was that taxpayers could claim the standard deduction or alternatively they could retain the current system of claiming a full deduction with substantiation. This was done to ensure that those who claimed in excess of the standard deduction would not lose out. The inevitable impact – had the proposal gone ahead – would have been a loss of revenue, as those claiming more than $500 continued under the old system, whilst those claiming less than $500 claimed the full standard deduction, in effect giving themselves a free tax cut.

For all the faults of the Rudd proposals, at least they recognised the inevitable - that most taxpayers will have to be tangibly better off if they are to buy into a proposal which they instinctively distrust.

That means that the abolition of work related deductions – which, without some form of compensation, stands to leave most taxpayers worse off – will need to be combined with other reforms which will compensate for the loss eg. a significant cut in the rates of income tax, a substantial increase in the tax free threshold, an uplift in the various tax brackets or a combination of all of those.

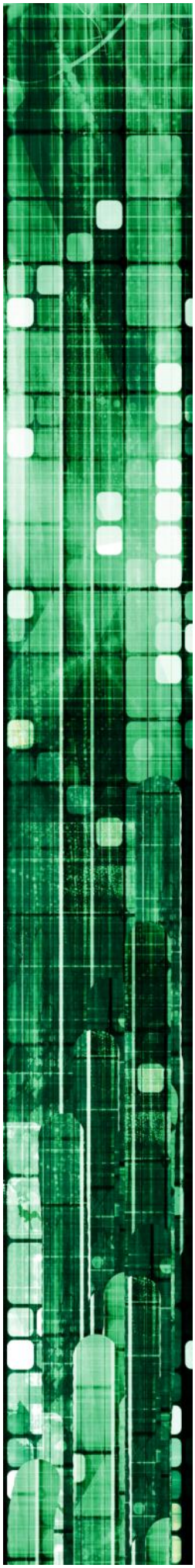
So, from being a proposal which should save revenue, the proposal actually becomes one which costs revenue. In the current climate of increasing government debt, a fiscally prudent government should not be prepared to suffer the budget pain they would be inflicting on themselves.

As for the ATO, the removal of deduction would undoubtedly introduce efficiencies in the short term. Removing deductions would give the ATO to chance to move towards a UK system, where the need for tax returns largely disappears. Staff currently engaged in time consuming and ultimately unproductive work chasing late and missing tax returns and auditing deduction claims, could be redeployed to verification and other audit type activities, or – more likely – removed altogether to save costs.

But the corresponding shrinkage in the tax agent population would remove a vital layer of quality control from the system. With fewer professionals to provide guidance on the interpretation of the law, there would be more requests for rulings from the ATO; more of those people who do lodge returns would lodge them incorrectly, which would flow through into higher administration costs for the ATO as they audit those taxpayers.

Perspective Nine:

The current system allowing employees to claim work-place deductions (and other deductions such as the cost of managing tax affairs) should be maintained in its current form. It is fair, easy to understand, sound from a policy perspective and popular with taxpayers.



Re:think question 16: To what extent does our FBT system strike the right balance between simplicity and fairness? What could be done to improve this?

Even by the standards of our complex tax system, FBT is an impenetrable tax. Even many tax professionals do not comprehend how it works, or even what the point of the tax is. Normal taxpayers cannot begin to comprehend the complexity of this tax. There are massive levels of non-compliance through failure to lodge FBT returns where employers have an obligation to do so, and even higher levels of non-registration for the tax in the first place, as employers who pay benefits choose to "fly under the radar" rather than enter the FBT system. The amount of resource devoted to FBT compliance by the ATO is low, meaning that non-compliance routinely goes undetected.

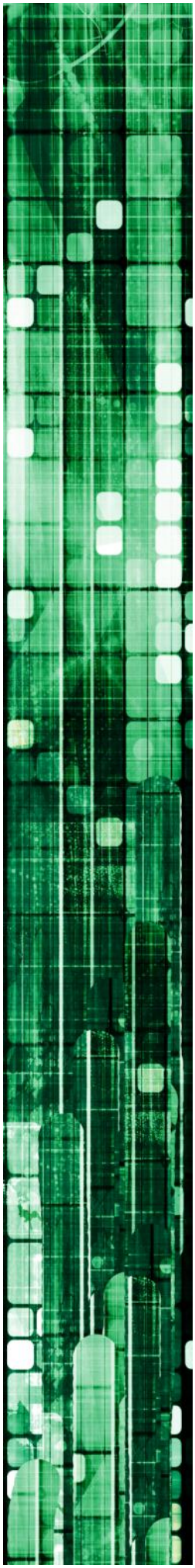
There are various levels of reform which can be considered.

At the simplest level, the FBT year should be aligned with the income tax year so that instead of two different reporting periods there is a common reporting period running to 30 June each year. This will reduce compliance costs and the record keeping burden on small businesses.

At a more fundamental level, consideration should be given to abolishing FBT altogether and integrating the employee benefits system into the income tax system. Adopting a UK style model, where benefits are taxed as income on the employee rather than the employer, based on the cost of the benefit provided, would reduce complexity, make the payments and allowances system more transparent and prevent revenue leakage through failure to participate in the system.

Perspective Ten:

Review the FBT system, including studying the feasibility of abolishing FBT altogether and absorbing it into the income tax system, with benefits taxed at the employee rather than the employer level.



Re:think question 23: What other ways to improve the taxation of domestic savings should be considered? How could they be applied in the Australian context?

With the increased reliance of the tax system on third party reporting, including of items such as dividend and interest income, we find it surprising that mandatory withholding of income tax has not yet been introduced on all forms of bank interest.

Such withholding – probably at one of the lower tax rates – would reduce compliance for millions of tax payers, make the administration of the system easier, reduce levels of tax debt and increase both the amount and timing of tax revenue flows into the system.

Re:think question 29: To what extent does the tax treatment of losses discourage risk-taking and innovation and hinder businesses restructuring? Would alternative approaches be preferable?

The current treatment of losses is restrictive. The ability to only carry losses forward means that it can be many years before new businesses see a tangible tax benefit from their losses. This may hinder risk-taking and stifles innovation.

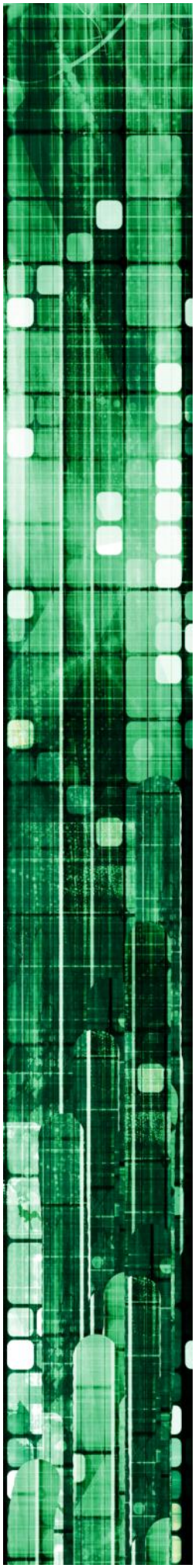
Whilst we believe that the restrictions imposed by the same business test and the continuity of ownership test are broadly appropriate, the ability to only offset tax losses in the future may be too harsh.

Consideration should be given to allowing tax losses incurred by a business or an individual in a particular year to be carried back up to three years in order to generate an immediate refund.

Further reforms could include allowing small businesses in start-up phase to have the ability to stream losses through to the owners of the business to generate refunds at the personal tax level, in order to provide stability and continued investment through this most difficult period of the businesses life.

Perspective Eleven:

Consideration should be given to introducing more flexibility into the recoupment of tax losses, particularly for small businesses, by, for instance, the ability to carry losses back against previous year's profits.



Re:think question 40: What other taxation incentives, including changes to existing measures, are appropriate to encourage investment in innovation and entrepreneurship?

Whilst we note that changes are currently underway to the tax treatment of employee share schemes, we believe it is essential that businesses in start-up phase, which are often incapable of making large remuneration payments, are able to use employee share ownership as a tax effective remuneration mechanism through the deferral of tax charges from the grant and exercise of the options to the point at which the shares are disposed of. This goes somewhat beyond where the current reforms are headed.

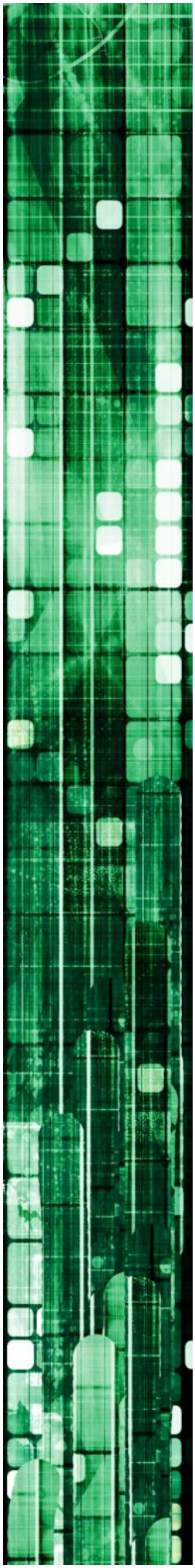
This will maximise incentives for new start-up businesses, enable them to secure the services of key employees and provide cash flow benefits at a time when cash is often scarce.

Perspective Twelve:

Consideration should be given to an extensive review of the system of taxing employee share ownership to provide maximum flexibility for start-up businesses in particular to use shares as a tax effective incentive mechanism.

Re:think question 44: What are the most significant drivers of tax law compliance activities and costs for small business?

The primary drivers of compliance costs are complexity and confusion. The need to engage professional assistance to understand tax obligations and the need to maintain complex tax record keeping and accounting systems in order to track income tax, PAYG, GST and super obligations imposes time and cost restraints on small businesses.



Re:think question 45: How effective is the current range of tax concessions (such as CGT and industry specific concessions) at supporting small business engagement with the tax system?

Whilst acknowledging the actual tax benefits of many of the concessions currently available (such as the small business CGT concessions), we believe that the complexity of the law in this area significantly undermines the value of these benefits.

Many businesses struggle to understand how the concessions apply to them, the array of complex criteria which need to be met before the concessions can be used can prevent some businesses from accessing the concessions at all and the existence of so many tests can encourage creative book-keeping to ensure that taxpayers meet the criteria.

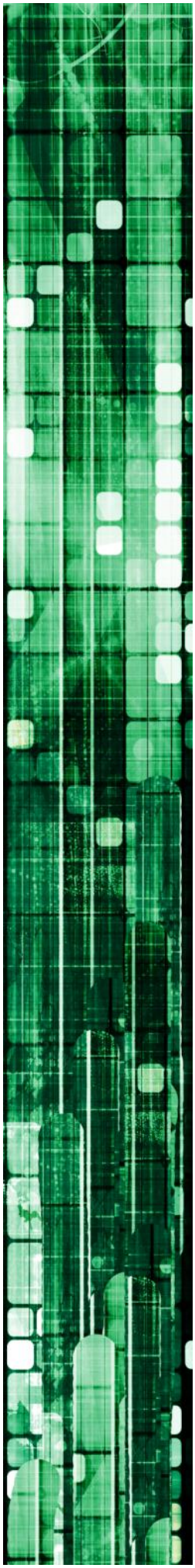
We believe that, starting with a statement of policy intent (what are the small business concessions actually for?), government should go back to the drawing board and radically simplify the law in this area, including investigating the possibility of reducing the large number of concessions down to just one or two, covering situations such as retirement and business disposal.

Where assets are held long term, the existence of the CGT discount already provides a tax benefit. A possible "double discount" could be automatically applied where a business asset is disposed of after – say – 15 years, so reducing the gain to nil.

In retirement situations, a form of retirement relief could be considered which would be automatically applied to exempt gains from CGT up to a defined level for all small businesses.

Perspective Thirteen:

Consideration should be given to a wholesale review of the small business CGT concessions to ensure that they are properly targeted, with clear criteria to qualify and framed by straightforward, east to follow law.



Re:think question 51: To what extent are the tax settings (that is, the rate, base and administration) for the GST appropriate? What changes, if any, could be made to these settings to make a better tax system to deliver taxes that are lower, simpler and fairer?

The current registration limit of $75,000 has been with us ever since the introduction of GST and is now far too low, bringing the smallest businesses within the scope of GST in a way that was never intended by the original lawmakers, increasing compliance costs and administrative burden.

An increase in the threshold would also reduce non-compliance as small traders currently seek to avoid GST by operating through the cash economy.

Perspective Fourteen:

Consideration should be given to raising the GST registration threshold to a level commensurate with that required to exempt the smallest businesses from GST. Taking into account the declining value of money since the introduction of GST in 2000, a GST registration threshold of $150,000 may be appropriate.

In addition, or as an alternative, greater use could be made of annual (rather than quarterly or monthly) reporting to reduce the compliance burden on small business.

Re:think question 57: Would there be benefit in developing an Australian metric for tax complexity? What factors should be included? How should they be combined into a metric?

We see limited benefit in developing such a metric. It could impose an additional layer of bureaucracy—and, ironically, complexity—into a system that is already burdened with too much of both. In addition, it is unlikely that taxpayers would understand such a metric.

Re:think question 59: In what ways can reforms of tax administration best assist in reducing the impact of complexity on taxpayers? Are there examples from other countries of tax administration reform to reduce the impact of complexity that Australia should adopt?

The current system of rulings, tax determinations, ATO guidance etc, is cumbersome, confusing and difficult for ordinary taxpayers to grapple with (and frequently difficult for tax professionals to grapple with). The system needs to be slimmed down, the instructions for interacting with the system need to be simplified and the results need to be properly communicated and publicised, not just to the applicant but to all taxpayers.

Re:think question 63: What changes could be made to provide greater certainty, transparency and accountability to tax policy development in Australia?

No tax legislation should be implemented retrospectively except in extreme circumstances to protect the revenue. It should be a hallmark of good government that taxpayers can rely on the law as it stands at a particular date. They should never have to worry that at some point in the future, the law may be changed in a way that negatively impacts them.

Law by press release should end since this creates confusion amongst taxpayers as to the correct application of the law between the date changes are announced and the date they are finally legislated, which in some cases is many years later[3]. No policy or law changes should be announced without draft supporting legislation being released at the same time. Implementation dates should be prospective and Treasury should set a clear timetable for the passage of legislation through Parliament, such that law will be guaranteed to be passed prior to the implementation date. Where there are delays for whatever reason, implementation dates should be deferred.

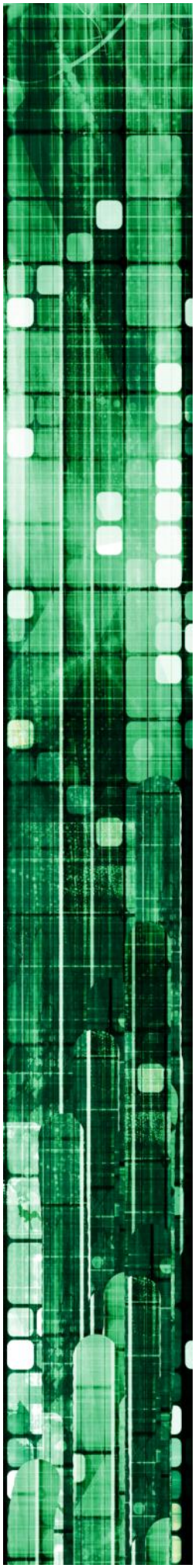
All new tax legislation should be independently scrutinised by a newly established committee of experts charged with auditing the simplicity and fairness of new tax law. Membership of that committee should be drawn from community groups representing individuals and business and should specifically not be drawn from Treasury or the tax/accounting professions.

Perspective Fifteen:

All tax legislation should be implemented prospectively (not retrospectively) unless there is a clear threat to tax revenue which needs to be addressed.

All new tax proposals should be presented with draft legislation already drafted and with a clear timetable to implementation.

4 See Treasury Press Release dated 6 November 2013 announcing the intention to review 96 unenacted measures, some of them announced as long ago as 2001. http://jbh.ministers.treasury.gov.au/media-release/017-2013/



Re:think question 64: Are current tax review arrangements appropriate? How could they be improved?

Whilst we applaud the role of the Inspector-General of Taxation in reviewing systemic issues with the ATO's administration of the system, we believe that the system of review and redress for particular taxpayers (whether individuals or businesses) is not sufficiently robust. In particular, there is a lack of legal redress for taxpayers, who find themselves victims of maladministration by the ATO. Taxpayers should have a statutory right to compensation where the ATO fails to abide by its own Taxpayers Charter.