National Tax & Accountants' Association Ltd

Tax White Paper Task Force

Submission

1 June 2015

Executive Summary

The National Tax & Accountants' Association Ltd ('NTAA') represents the interests of over 9,000 tax agent practices, taxation accountants and business advisers.

We welcome the opportunity to make a submission to the Tax White Paper Task Force and acknowledge the efforts of the Australian Treasury in engaging with relevant stakeholders as a part of this vital review and detailed consideration of the challenges that face Australia's tax system.

Our organisation's submission focuses on particular issues raised in *Re:think Tax Discussion Paper* ('Re:think') as well as other matters we consider crucial to the ongoing debate and discussion as to what Australia's tax system should look like in order to tackle the challenges posed by an ever-changing world.

Our organisation's submission focuses on the following areas:

- What are the major challenges in relation to the taxation of individuals?
- What is the best way to tax fringe benefits and how can the taxation of fringe benefits be improved?
- What changes can be made to the administration of Australia's tax system which will aid in the goal of simplification of the taxation system?
- What are the pressing issues to consider in relation to the taxation of superannuation and retirement income?

The NTAA makes the following recommendations in relation to the above areas, for consideration in the Tax White Paper process:

Income Tax Recommendations

Recommendation 1

Whilst acknowledging that pre-filled individual tax returns are a useful tool for taxpayers and tax agents alike, given the inherent limitations of the pre-filling data collection and aggregation process, pre-filled returns should not be viewed as a substitute for properly prepared individual tax returns.

Any over-reliance on pre-filled returns is almost certainly going to result in the tax liability of individual taxpayers being overstated as it is much easier for the ATO to capture information on income than it is to capture information on expenses.

Recommendation 2

In order to achieve the objectives of equity and fairness, our tax system must continue to allow employees to claim legitimate work-related expenses as tax deductions.

It is highly likely that any attempt to remove or 'standardise' claims for work-related expenses will be greeted with much disapproval from many individual taxpayer occupations/professions. For example, tradespeople, medical staff and teachers are likely to view any reform that simplifies the individual tax return by introducing standard deductions as a *de facto* tax increase where the 'standard' claim is less than the claims made by taxpayers in these occupations. Such a reform is likely to be challenged by not only occupational groups but also trade unions whose members may be adversely affected by such a reform.

Moreover, even if standard deductions for individuals were ever to be introduced, individuals must retain the right to make a claim for *actual* deductions, where their actual claim is greater than a standard deduction threshold.

To deny employees the right to claim tax deductions would simply be the raising of additional revenue in an unfair and unjust manner. To justify such an action using words such as 'simplicity' and 'reform' would be an exercise in political sophistry.

Recommendation 3

Wherever possible, the Individual Tax Return be simplified as long as any proposed simplifications are not at the expense of fairness or integrity.

Recommendation 4

That the existing treatment of negatively geared investments be retained. However consideration should be given to quarantining deductions against rental income and any capital gain generated by the investment, for negatively geared investments held by non-residents. This quarantining should also be considered for non-residents who subsequently become Australian residents.

Recommendation 5

That the CGT discount be retained. However, if a change is found to be warranted, consideration should be given to the implementation of a gradual CGT discount, starting, for example, at 30% for individuals and trusts that have held a CGT asset for at least 12 months, moving up 10% every year, until the discount reaches 50% after three years.

Recommendation 6

That existing dividend imputation arrangements remain in place. Dividend imputation is designed to avoid the incidence of double taxation of company profits. To remove dividend imputation, even if accompanied by a substantial reduction in the corporate tax rate, will still leave resident Australian shareholders worse off.

FBT Recommendations

Recommendation 7

That the taxation of non-cash benefits provided to employees remains a tax payable by employers under the FBT rules as this is the fairest and most efficient way of taxing non-cash benefits.

Recommendation 8

That measures to simplify the documentation, evidentiary and paperwork requirements relating to FBT for employers be explored. The ATO's recently created FBT Safe Harbour Working Group is a good start for the commencement of this process.

Recommendation 9

That the FBT year-end of 31 March remains unchanged. The differentiation between the FBT and income tax year-ends allows for employers and tax agents alike to stagger their workloads.

Recommendation 10

The FBT Act should be modernised such that asterisks are used to denote defined terms throughout the Act and all defined terms are contained in the 'dictionary' section of the Act.

Recommendation 11

Consideration should be given as to whether there are instances within the FBT legislation where valuation methodologies could be simplified, so long as this does not lead to a compromise on fairness.

For example, in relation to car parking fringe benefits, consideration could be given to removing the least-often used methods (of the three currently available) to determine both the number of spaces provided and the value of these spaces. As a further example, consideration could be given to simplifying the valuation of in-house property benefits.

Administration Recommendations

Recommendation 12

That the quality and consistency of Private Binding Rulings ('PBRs') be improved by providing ATO staff involved in the process of issuing PBRs with improved training. By improving the quality of the PBR process the objectives of efficiency, fairness and integrity are enhanced.

Recommendation 13

Measures to improve the turnaround time of PBRs should also be considered.

Recommendation 14

That the ATO provide improved tax technical training to its frontline staff who operate the ATO's Tax Agent Services Line, 13 72 86.

Recommendation 15

That when seeking information from both tax agents and taxpayers as part of a review/audit process, the ATO applies fair and reasonable timeframes for the provision of requested information.

Recommendation 16

That the ATO has clear procedures in place when communicating with taxpayers (either in writing or over the phone) and that wherever possible, where a taxpayer is represented by a tax agent, the tax agent should be the appropriate communication point unless the client has agreed to an alternative arrangement. That communication directly between the ATO and taxpayers does not result in an outcome more favourable than that achieved via communication between the ATO and a tax agent (e.g., remission of penalties and interest).

Recommendation 17

That the ATO acts in a cautious and considered manner in its application of electronic data mining techniques as the basis of sending letters to taxpayers indicating that an amended assessment will be issued. The ATO should have a high degree of certainty as to the existence of an alleged mistake in a taxpayer's return before sending out a letter indicating an amended assessment is imminent.

Superannuation Recommendations

Recommendation 18

The ongoing entitlement of superannuation funds (including SMSFs) to claim income tax and CGT exemptions should be confirmed to restore 'fairness' and 'simplicity' to these rules. The current level of uncertainty is undermining the tax system in relation to this issue.

Recommendation 19

Consideration should be given to the introduction of a *de minimis* rule whereby an actuarial certificate is not required for SMSFs in both accumulation and pension phase where 'segregation' is not used and where the balance of entitlements within the SMSF is below a particular threshold. As an alternative, trustees should be able to apply a simple mathematical calculation based on an average of balances in accumulation and pension phase.

Recommendation 20

Consideration should be given to whether the document retention period for the minutes of meetings of trustees could be reduced. A suggested appropriate period would be five years.

Recommendation 21

To enable individuals to better prepare and save for their own retirement, consideration should be given to raising the concessional contributions capping threshold for individuals aged 50 or over. A suggested level is $60,000.

Other Matters - Recommendations

Recommendation 22

Where the ATO changes a previously held position relating to the application of a tax law, especially in relation to superannuation matters, wherever possible it should allow taxpayers that entered into arrangements prior to the new position being made public, ongoing reliance on the ATO's former position, so long as the arrangement entered into prior to the new view being made public remains in place.

Recommendation 23

Consideration should be given to exploring ways by which the definition of 'employee' could be harmonised amongst various Federal tax and superannuation legislation. Furthermore, consideration should also be given to an initiative whereby States and Territories are also involved in the project of harmonisation in relation to the definition of 'employee'. The need for businesses that operate in more than one state or territory to become familiar with multiple definitions of 'employee' pertaining to numerous taxes and employer obligations is an example of overly burdensome red tape that needs to be addressed.

Preamble

When designing a tax system or considering changes to elements of an existing tax system, we note that there are numerous conflicting objectives that policy makers have in mind:

- **Efficiency**: the imposition of tax on an economic activity will ordinarily have the effect of reducing the incidence of that activity. An efficient tax is one that minimises these economic distortions when compared to other tax-raising alternatives.
- **Integrity**: a tax needs to have rules in place which seek to ensure that taxpayers cannot avoid the tax through artificial or contrived means that would not be deployed but for seeking the aim to achieve the avoidance of the tax.
- **Simplicity**: wherever possible, a tax should be simple in its design and in its application, as this assists in acceptance of the tax by those on whom it is imposed and minimises the cost of complying with the tax.
- **Equity/Fairness**: the burden of any tax should not be so great that it is considered oppressive and unjust by those on which it falls.
- **Revenue Adequacy**: a tax, or the totality of different taxes a government body has at its disposal, should raise sufficient revenue to pay for the expenses of that government body.

These objectives can often be contradictory with one or more objectives being obtained only with reference to the sacrifice of another. For example, when it comes to the taxation of individual salary and wage earners, no doubt it would certainly simplify the application of a tax system if individuals were denied the ability to claim any tax deductions relating to their wages. Whilst this achieves the objective of simplicity, it completely fails the objective of fairness – as taxpayers have numerous legitimate expenses that have a direct connection to the earning of their assessable income, namely their wages.

So it can be seen that if undue emphasis is placed on simplicity, the objective of fairness is lost. Taxpayers would rather not have the extreme simplicity described above if it means that they lose their entitlement to claim legitimate deductions.

This is not to say that the NTAA views the objective of the pursuit of simplicity in the realm of tax systems and their design as being without merit. A tax system should not be needlessly complicated. The burden of complex law should only be tolerated where the complexity is necessary and justifiable with reference to other objectives such as fairness, integrity and revenue adequacy.

The *raison d'être* of the Tax White Paper process is to assist in providing a 'better tax system' and a 'better Australia'. The pursuit of simplicity for its own sake, without careful reference to other equally important objectives of fairness, efficiency, integrity and revenue adequacy - would result in policy outcomes that fail to deliver on these twin ideals: Better tax system, better Australia.

A recent example of the Federal Government identifying an instance of complexity in the Australian tax system and proposing a remedy that we applaud was the 12 May 2015 Budget Night announcement that two of the four methods currently available for individuals to claim tax deductions for car expenses under Division 28 of the *Income Tax Assessment Act 1997* ('ITAA 1997') are to be removed with effect from 1 July 2015.

More specifically, as per the recent Budget Night announcement, it is proposed that the 12% of original cost and the 1/3rd of actual expenses methods are to be removed, with Treasury indicating that less than 2% of individual taxpayers use these two methods to claim work-related car expenses.

Given the cents per kilometre and 12-week log book methods still remain available to individual taxpayers, we see this proposed change as an example of where the simplicity objective has been achieved without there being an overly negative impact on fairness. We do not see this

proposed measure as having any undesirable outcomes in the spheres of efficiency or revenue adequacy.

The comments, observations and recommendations made hereunder seek to apply the principles of efficiency, integrity, simplicity, fairness/equity and revenue adequacy in a balanced manner, to different facets of tax system design.

1. Reforms and issues associated with the 'Individual Income Tax Return'

The taxation of individuals is an important part of Australia's tax system. Recently released ATO statistics indicate that for the 2012-13 income year, approximately 12.7 million individual taxpayers paid approximately $155 billion dollars in tax, with revenue collected from individual income tax representing about 50% of all taxation receipts collected by the ATO.

Accordingly, the significance of tax system design features and how these features affect individual taxation cannot be underestimated.

1.1 The limitations of ATO electronic pre-filling of Individual Tax Returns

In recent years, the ATO has increasingly moved towards pre-filling individual tax returns by taking advantage of its electronic data collection on matters such as individual PAYG Payment Summaries (addressing salaries, allowances, tax withheld by an employer), interest income from banks, dividend income from listed companies, private health insurance policy information, etc.

Overall, this is seen as a positive development, as it gives individual taxpayers and their tax agents the ability to verify and confirm data with ATO records prior to actual lodgment.

Whilst the use of pre-filled data to assist in tax return preparation is a positive development, it should not be seen as the means by which the need for Individual Tax Returns can be dispensed with altogether.

The tax system has various unavoidable complexities associated with it (for example, the application of the non-commercial loss rules). Likewise, an individual's taxation affairs will often entail subtleties and nuances that simply do not lend themselves to a return prepared 100% by the ATO on a pre-fill basis.

It seems that it is far easier to electronically gather information pertaining to an individual's income than it is to collate such information in relation to their expenses.

So an over reliance upon pre-filled returns could lead to many individual taxpayers not claiming legitimate deductions relating to the derivation of their assessable income which they are entitled to claim.

Moreover, the moment that a relatively common occurrence of a rental property is added to an individual's affairs or a CGT event such as the disposal of some long held ASX listed shares, the ability of the ATO to offer a fully pre-filled return dissipates.

Pre-filling can certainly be a valuable tool in assisting with the preparation of individual tax returns. Pre-filling does help reduce the complexity of preparing individual tax returns but it is not of itself, a replacement for the preparation of individual tax returns.

In brief, a pre-filled Individual Tax Return prepared by the ATO should be seen as nothing more than a rough draft of the final return to be lodged.

It is vital in the interests of integrity and fairness that no changes to the tax system are implemented which, in any way, reduce an individual's right to have their own tax return correctly prepared. The return should take all relevant matters into account, not just those already known by the ATO as reflected in the pre-fill process.

1.2 Claiming work-related expenses

Re:think at discussion question 15 asks the following:

> *To what extent do our arrangements for work-related expense deductions strike the right balance between simplicity and fairness? What can be done to improve this?*

The NTAA considers that, on the whole, the existing arrangements in relation to work-related expenses do strike the right balance between simplicity and fairness.

That individuals claim deductions against their salary and income for work-related expenses should be considered unremarkable.

Businesses are taxed, broadly speaking, not on their gross turnover, but rather on their net profit (that is, after taking into account relevant expenses).

Similarly, individual salary and wage earners are currently taxed, broadly speaking, not on their gross salary, but on their salary net of expenses that have the requisite nexus to the earning of their salary. This treatment is hardly a 'lurk' or a 'perk', but rather something afforded out of fairness.

Consider the following example where there are two individuals, each earning a salary of $70,000. One of the two individuals, Sally, has legitimate work-related expenses of $1,000. The other individual, Marley, has no work-related expenses. In the interests of fairness, Sally, who has $1,000 of work-related expenses, has a taxable income of $69,000, whereas, Marley, who has no work-related expenses has a taxable income of $70,000.

Much negative discussion and commentary in the popular press about the tax deductibility of work-related expenses seems to be driven by ignorance.

With reference to the illustrative example above, it would be manifestly unfair if, under the guise of pursuing 'simplicity' for simplicity's own sake, Sally was denied a deduction for her $1,000 of work-related expenses (or only allowed a reduced deduction to a specified 'notional' amount). Conversely, it would also be unfair if Marley, despite not having a cent of work-related deductions, was able to claim an arbitrary 'standard deduction' amount.

In order to secure her $1,000 of work-related deductions, Sally may have been required to meet documentation and substantiation requirements such as keeping receipts and maintaining a 12-week log book (in relation to car expenses). It would be most disingenuous to argue that a blanket denial of these work-related deductions is somehow justified on the basis that it achieves a level of 'simplification' in the tax system. The documentation requirements referred to in this example are by no means onerous.

1.2.1 Taxpayers who would be most disadvantaged by a blanket denial of work-related expenses

In recent years, especially with modifications to the 'statutory formula method' of valuing car benefits, which took effect from 7.30pm (EST) 10 May 2011, many employers have moved away from providing car fringe benefits to employees and are instead providing car allowances to employees. Accordingly, more employees have to deal with consequences of using privately held cars for work-related purposes.

For employees engaged as sales representatives or other employees where daily travel to multiple client sites is an integral part of their job, the ability to claim a deduction where a privately held car is used for genuine work purposes, is hardly seen as something that is a 'tax-dodge'.

Any attempt to deny deductions for work-related expenses, or to place an arbitrary cap on deductions for work-related expenses, will only serve to punish those taxpayers, who, through no fault of their own, find themselves engaged in employment which requires ongoing work-related travel.

Furthermore, employees in certain industries, such as mining, building and construction, often have large deductions for work-related expenses. This is in part due to deductible work-related travel, but also employees in these industries often have various claims for deductible equipment (whether the claim is an outright deduction or a capital allowance claim).

In fact, many occupations that traditionally derive lower income levels (e.g., tradespeople, nurses and sales representatives) often have large work-related expenses claims as a percentage of their income. To deny these taxpayers the right to claim work-related expenses would be penalising the more vulnerable within our community and impose an unfair increase of tax on these taxpayers.

If misguided 'tax reform' was to ever deliver the removal (or a capping) of deductible work-related expenses, it is reasonable to assume that in heavily unionised industries with a tendency for high claims of work-related expenses, such as construction and mining, there would be understandable pressure from unions for employers to increase the salaries and allowances of employees in these industries.

Such pressure placed by unions on employers would be based on a desire not to increase an employee's overall remuneration, but rather to simply maintain an employee's current standard of living such that they have the same after-tax income in an environment where work-related deductions are denied (or limited).

1.2.2 Work-related deductions and self-education

In May 2013, the former Federal government announced in the 2013-14 Budget that there would be a cap of $2,000 placed on the deductibility of self-education expenses (e.g., training and educational courses, textbooks and other accreditation expenses). Soon after being elected, the current Coalition government announced that it would not be proceeding with this proposal.

Self-education expenses are often a strong driver of large claims for work-related expenses.

As an example of how costly legitimate self-education can be, numerous Masters degrees and post-graduate courses offered by 'Group of Eight' universities can cost in the vicinity of $4,000 per subject. This means that an eight subject Masters degree directly relating to an individual's ongoing employment, could give rise to approximately $32,000 of deductions over the duration of the degree.

Medical practitioners, engineers, accountants, lawyers and finance professionals (to name but a few professions) often have requirements imposed upon them by the professional association of which they are a member, to undertake a certain number of hours in ongoing training and education every year. The point of this training is to ensure that the professional keeps up-to-date with developments in their chosen field and continues to offer professional services of the highest calibre.

In many instances, employers do not cover the cost of such ongoing education undertaken to maintain one's status or designation within a particular profession, despite the employer clearly gaining from having a better educated workforce.

That there is a clear and obvious nexus to the earning of assessable income in relation to the ongoing work-related self-education described above is not in doubt.

However, any attempt to deny (or place a cap) on deductions for work-related education would have deleterious consequences for the overall productivity of the Australian workforce.

A denial of deductions for work-related expenses, which would by its very nature, include deductions for work-related self-education, would drastically reduce the impetus for taxpayers to incur expenses that are designed to improve their credentials or skills with their current employer.

Successive governments have made it clear that they want a 'smarter Australia', a more productive Australia where having a well-educated workforce is vital to driving future development and economic growth.

Any attempt to remove (or to place a cap on) the right of taxpayers to claim self-education expenses under the banner of denying deductions for work-related expenses, is counter intuitive to achieving a 'smarter Australia'.

To qualify as a deduction, broadly speaking, work-related self-education must not be seen as too preliminary to the earning of assessable income. This means that the cost of obtaining an undergraduate degree so as to obtain work in a particular profession is generally seen as not having a sufficient nexus to the earning of ongoing assessable income. This is because it assists the taxpayer to earn future assessable income. Such existing limitations on the deductibility of self-education are viewed as fair and reasonable.

However, any attempt to provide an outright denial (or limitation subject to a cap) of tax deductions relating to self-education work-related expenses would be detrimental to the longer-term interests of the Australian economy and fails the fairness criterion for employees denied these deductions.

1.2.3 Standard deductions for work-related expenses

In the 2010-11 Federal Budget, the then Treasurer Wayne Swan, announced a standard deduction for work related-expenses of $500 proposed to take effect from 1 July 2012, and increasing to $1,000 from 1 July 2013. Under the 2010-11 Budget proposal, taxpayers would have still retained the ability to claim more than the standard deduction amount where they had substantiated expenses greater than the standard deduction amount.

The former government ultimately dropped this 2010-11 Federal Budget proposal and therefore it was not enacted.

If the introduction of 'standard deductions' was ever to be reconsidered, it is important that individual taxpayers retain the right to claim a deduction for work-related expenses that happen to exceed the standard deduction threshold, whatever it might be.

Standard deductions, if ever introduced, must not become a replacement for *actual* work-related deductions.

If it were to ever eventuate that a capped standard deduction was to replace a deduction for *actual* work-related expenses, then this would be seen as nothing other than a revenue raising measure based upon the abandonment of fairness for individual taxpayers. Any attempt to defend such a policy measure on the grounds of 'simplicity' could not be taken seriously.

1.3 The role of the Individual Tax Return

The following discussion considers the role played by the Individual Tax Return in not only Australia's existing tax framework but also other incidental benefits of Individual Tax Returns.

1.3.1 The role of the Individual Tax Return – whole of government implications

The information contained within an Individual Tax Return is not just applied to achieve the obvious objective of determining an individual's taxable income and associated income tax liability.

The information contained within an Individual Tax Return is applied for a multitude of other purposes. Some of these include enabling other government departments and agencies to make determinations as to the administration of the numerous federal government provided subsidies and transfer-payments.

The operation and application of the following benefits/rebates/payments/taxpayer obligations is based at least in part, upon information furnished in an individual's tax return:

- Private Health Insurance Rebate;
- HECS-HELP debt repayments;
- Child support obligations;
- Family Tax Benefits Part A and B;
- Veterans pensions;
- Age Pension;
- Disability Support Pension;
- Newstart Allowance;
- Youth Allowance; and

- Carer Payment.

Welfare entitlements and other government concessions are targeted to those most in need and are generally income tested. As such, government agencies require information about an individual taxpayer's income level for a particular income year in order to determine their eligibility for these entitlements.

Naturally, it would be imperative to ensure that any simplification of Individual Tax Returns does not result in other government departments and agencies having insufficient or unreliable information when it comes to applying various 'income tests' necessary to determine eligibility for a transfer-payment or other concession.

Such attempts could also make it more difficult for the Department of Human Services to determine the level of financial support required from non-custodial parents towards custodial parents.

1.3.2 The role of the Individual Tax Return – Integrity Measures

There are numerous instances of specific rules within the tax system that are designed to maintain its integrity. By way of example, the 'non-commercial loss rules' demand very specific information to determine if an individual taxpayer can offset a loss from a business activity against other assessable income.

The inclusion of various labels specific to the application of non-commercial losses adds to the overall complexity of the Individual Tax Return. However, the inclusion of these labels would be justified by policy makers on the basis that it aids in the application of important integrity measures.

Similarly, the disclosures required under the 'Income Tests' labels undoubtedly add to the complexity of the Individual Tax Return.

Amongst other items, the 'Income Tests' labels include disclosures relating to reportable fringe benefits, reportable superannuation contributions, net financial investment losses and net rental property losses.

These disclosures are required for a myriad of integrity related reasons, and are used to determine eligibility or the calculation of:

- deductible personal superannuation contributions;
- liability for the Medicare Levy Surcharge;
- liability for HECS-HELP loan repayments;
- amount of Private Health Insurance rebate; and
- access to various tax offsets

Many of these 'Income Tests' labels (Labels IT1 to IT8 of the 2014 Individual Tax Return) are not capable of being pre-filled by the ATO and therefore require taxpayers or their tax agent to undertake the necessary work to complete them.

Nevertheless, despite the complexity associated with these labels, it is arguable that for integrity related reasons, it is still considered desirable that they are included in the Individual Tax Return.

1.3.3 The role of the Individual Tax Return – Keeping taxpayers engaged in the tax collection system

A significant advantage of requiring the lodgment of an annual income tax return by individual taxpayers is that it demands all taxpayers participate annually in the tax system.

This requirement of ongoing annual participation by taxpayers helps ensure that the information provided to the ATO is accurate and reliable.

It is not difficult to envisage a system based upon the ATO electronically aggregating data and making its own determination as to an individual's taxable income. However, if there is a recently acquired positively geared rental property that has not been identified by the ATO's data matching process, the individual concerned will have little or no incentive to advise the ATO of the missing rental income from a pre-filled return (or may in fact simply not be aware of the oversight).

It is also feared that in a tax system with the hypothetical removal of the need to lodge an annual tax return, it would be difficult for government agencies (including the ATO) to identify those taxpayers operating outside the tax (and possibly the legal) system.

Moreover, where a tax agent has been involved in the tax return preparation process, the ATO is the beneficiary of a review (by the tax agent) of the information presented to the ATO in the lodged return. Relying solely upon electronically generated information for the issuing of assessments would inevitably lead to many assessments containing incorrect and unreliable information, putting at risk the integrity of the taxation system.

1.4 Simplifying the Individual Tax Return

The NTAA supports any well-considered attempts to simplify the Individual Tax Return.

Of crucial importance, any policy proposal which purports to 'simplify' the Individual Tax Return should be rejected if it unduly prejudices fairness and integrity.

For example, consider a hypothetical policy proposal of removing all deductions for individuals at Labels D1 through to D10. If this hypothetical policy was justified on the basis "it keeps life simple for taxpayers – no need to keep those pesky receipts!" this would be considered as disingenuous and such a policy would be viewed as a *de facto* tax increase under the guise of tax simplification.

Such a hypothetical change (complete denial of deductions) would give taxpayers a level of simplicity they would happily live without.

1.4.1 Areas within the Individual Tax Return that could be made simpler

A. Private Health Insurance policy details

The labels pertaining to Private Health Insurance ('PHI') policy details required for the correct calculation of the Private Health Insurance rebate, can be confusing. Errors are commonly made with these disclosures. These labels are complicated due to the following factors:

- The PHI rebate percentage changes on 1 April of each income year, requiring details of PHI premiums to be broken up into two periods, one from 1 July to 31 March, the other from 1 April to 30 June.
- If an individual changed their PHI provider during the income year such that at different stages throughout the one income year they had two or more health insurers, this requires an additional disclosure.
- Determining the correct 'Tax Claim Code' is difficult as the appropriate code varies depending on whether the individual taxpayer has dependants or not, and whether a taxpayer's spouse is claiming the taxpayer's share of a rebate.

Consideration should be given to see if there are simpler ways to collate the necessary information to correctly apply and calculate the PHI rebate.

B. Medicare Levy and Medicare Levy Surcharge Labels

The Medicare Levy and Medicare Levy Surcharge labels (M1 and M2) also cause confusion.

The application of the Medicare Levy exemption for certain types of taxpayers (e.g. Australian Defence Force Members in receipt of full free medical treatment, blind pensioners, taxpayers not entitled to Medicare benefits, etc.) can be confusing where a taxpayer is entitled to only a partial

exemption because they have a spouse and/or other dependents who are not eligible for the exemption.

Our members routinely advise of mistakes being made in relation to those taxpayers that are only entitled to a partial Medicare Levy exemption.

The need to complete Item M2 (regarding the Medicare Levy Surcharge), a compulsory label, can be a source of frustration for many taxpayers whose income is less than the relevant Medicare Levy Surcharge threshold.

Furthermore, the reasoning behind the necessity to complete Item M2 is less than obvious where a taxpayer has disclosures at the Private Health Insurance policy details which clearly show the taxpayer paid health insurance premiums for the full income year.

Consideration should be given to see if there are more straight forward ways to collate the necessary information to correctly calculate the Medicare Levy and Medicare Levy Surcharge.

C. Spouse details – married or de facto

The spouse details labels, currently labels 'O' through to 'F' (twelve labels in total), can be very difficult for taxpayers to complete. These labels are used, amongst other things, to determine a taxpayer's eligibility to claim Family Tax Benefits Parts A and B.

For numerous reasons, spouses do not necessarily always lodge their income tax returns at or about the same time as each other. However, for these labels to be correctly completed, the tax system is indirectly foisting an obligation onto taxpayers with a spouse to lodge at the same time as each other, or to at least have their respective tax returns prepared concurrently.

Consideration should be given to whether it is possible to streamline labels 'O' through to 'F'.

Given the Individual Tax Return already asks for the name and date of birth of a taxpayer's spouse, it would be reasonable to expect that the ATO's data matching processes are capable of 'sharing' this information where necessary for taxpayers that have a spouse.

Moreover, if this data could be harvested by the ATO after both spouses have lodged their respective tax returns, the likelihood that correct information is shared between spouses would be far greater. For example, if a taxpayer with a spouse has a sense of urgency about lodging their own tax return (because they are expecting a large refund) and they do not know their spouse's taxable income for the year in question, they are likely to simply take an educated guess when completing label 'O' under Spouse details.

It should also be noted that in some instances spouses may not necessarily want the other spouse to know their taxable income.

1.5 Negative gearing and CGT discount

Re:think quite rightly notes that "*Negative gearing does not, in itself, cause a tax distortion, but it does allow more people to enter the market than those who might have had the equity alone to do so*."

Re:think also states "*Contrary to popular perception, negative gearing is not a specific tax concession for taxpayers with investment properties – it is simply the operation of Australia's tax system allowing deductions for expenses incurred in producing assessable income*."

The NTAA supports the retention of existing arrangements in relation to interest deductibility where the borrowed funds have been used to acquire an income generating asset.

Broadly speaking, Division 35 of the ITAA 1997 seeks to quarantine business losses an individual may have from a non-commercial business activity that is unlikely to produce taxable income. A negatively geared investment in a rental property is to be differentiated from this. It is simply an investment whereby in the earlier years the interest expenses will outweigh rental income but over the life of the investment, it is expected that the rental property will produce

taxable income. In short, it is a commercial arrangement that will generate net rental income and a capital gain on disposal.

Attempts to deny a tax deduction for interest deductions that exceed associated rental income would almost certainly result in an increase in rental prices. This is because taxpayers owning negatively geared investment properties would seek to increase rents to, at least in part, address the economic benefits of the forgone interest deduction.

Consideration should also be given to the efficacy of allowing non-residents to accumulate large amounts of tax losses over a number of years associated with negatively geared investments. These accumulated losses can ultimately be used to reduce the tax payable if the non-resident ever becomes an Australian resident for tax purposes and then earns other Australian-sourced income, such as a salary. Given that non-residents are not otherwise contributing to the Australian economy during the period of their non-residency, there could be an argument to quarantine a non-resident's losses from negatively geared investments to future income (or any capital gains) from the same investment.

1.6 CGT discount

The 50% CGT discount for assets held for at least 12 months has been a part of the landscape of the Australian tax system since 21 September 1999. The 50% discount for individuals and trusts (and the 33 1/3% discount for complying superannuation funds in accumulation phase) replaced the previous arrangements whereby a CGT asset's cost base was increased by CPI movements. This was to ensure that a capital gain upon the sale of an asset represented only the *real* growth in the asset's value from the time it was acquired until when it was sold, as opposed to *nominal* growth.

Re:think observes "*Purchasers can make bigger investments in property by borrowing, in addition to using their own savings. The behavior is encouraged by the CGT discount, as larger investments can result in greater capital gains and therefore benefit more from the CGT discount*."

The NTAA strongly supports the retention of the CGT discount in its current form.

However, if changes were to be made, consideration could be given to it existing in a modified form.

For example, whereby the size of the discount increases the longer an asset is held, thus rewarding taxpayers that hold CGT assets for a longer period of time.

For example, the CGT discount for individuals and trusts could start at 30% for assets held for at least 12 months, and for every extra year the asset is held, the discount increases by 10% every year until at year three it reaches the maximum discount amount of 50%. Such an approach may dissuade short-term speculative investment.

1.7 Franking credits and dividend imputation

Australia has had dividend imputation since 1987. Put simply, dividend imputation avoids the incidence of the double taxation of company profits.

Any policy proposal to remove or modify the application of dividend imputation needs to be considered against the reason for its existence: the avoidance of double taxation.

It has been suggested by some commentators in Australia's financial press that the corporate tax rate could be 'slashed' in a tax system without dividend imputation and that this would somehow compensate shareholders faced with double taxation.

The analysis provided below (Figure 1) demonstrates the fallaciousness of the notion that slashing the company tax rate (in this case, by one-third, from 30% to 20%) would compensate shareholders for the loss of dividend imputation.

Figure 1

	Company taxable income	1,000	1,000	1,000	1,000	1,000
	Company tax 30%/**franking credit**	300	300	300	300	300
	Cash net of Company tax	700	700	700	700	700
	Individual shareholder's tax rate (1)	0%	21.00%	34.50%	39.00%	49.00%
	Tax paid (incl. franking credit)	0	210	345	390	490
	Shareholder's Cash after tax	1,000	790	655	610	510
	Company taxable income	1,000	1,000	1,000	1,000	1,000
	Company tax 20%/**NO franking credit**	200	200	200	200	200
	Cash net of Company tax	800	800	800	800	800
	Individual shareholder's tax rate (1)	0%	21.00%	34.50%	39.00%	49.00%
	Tax paid (NO franking credit)		168	276	312	392
	Shareholder's Cash after tax	800	632	524	488	408
	Detriment to shareholder without franking	**200**	**158**	**131**	**122**	**102**

(1) The individual tax rates applied are for individual residents and take into account the 2% Medicare levy and the 2% Temporary Budget Repair Levy (where applicable) for the 2014-15 income year.

The scenario considers the net after-tax cash position of a resident individual shareholder receiving a fully-franked dividend with imputation where the corporate tax rate is 30% compared to the net after-tax cash position of a resident individual shareholder without imputation and with a 20% corporate tax rate.

To reiterate, any attempt to remove or modify dividend imputation must be viewed through the lens of introducing double taxation of dividends to Australian shareholders, which strikes at the core of fairness. Moreover, it is actually lower to middle income earners that are hurt the most if dividend imputation is removed.

1.8 Conclusions and recommendations regarding individual income tax

Recommendation 1

Whilst acknowledging that pre-filled individual tax returns are a useful tool for taxpayers and tax agents alike, given the inherent limitations of the pre-filling data collection and aggregation process, pre-filled returns should not be viewed as a substitute for properly prepared individual tax returns.

Any over-reliance on pre-filled returns is almost certainly going to result in the tax liability of individual taxpayers being overstated as it is much easier for the ATO to capture information on income than it is to capture information on expenses.

Recommendation 2

In order to achieve the objectives of equity and fairness, our tax system must continue to allow employees to claim legitimate work-related expenses as tax deductions.

It is highly likely that any attempt to remove or 'standardise' claims for work-related expenses will be greeted with much disapproval from many individual taxpayer occupations/professions. For example, tradespeople, medical staff and teachers are likely to view any reform that simplifies the individual tax return by introducing standard deductions as a *de facto* tax increase where the 'standard' claim is less than the claims made by taxpayers in these occupations. Such a reform is likely to be challenged by not only occupational groups but also trade unions whose members may be adversely affected by such a reform.

Moreover, even if standard deductions for individuals were ever to be introduced, individuals must retain the right to make a claim for *actual* deductions, where their actual claim is greater than a standard deduction threshold.

To deny employees the right to claim tax deductions would simply be the raising of additional revenue in an unfair and unjust manner. To justify such an action using words such as 'simplicity' and 'reform' would be an exercise in political sophistry.

Recommendation 3

Wherever possible, the Individual Tax Return be simplified as long as any proposed simplifications are not at the expense of fairness or integrity.

Recommendation 4

That the existing treatment of negatively geared investments be retained. However consideration should be given to quarantining deductions against rental income and any capital gain generated by the investment, for negatively geared investments held by non-residents. This quarantining should also be considered for non-residents who subsequently become Australian residents.

Recommendation 5

That the CGT discount be retained. However, if a change is found to be warranted, consideration should be given to the implementation of a gradual CGT discount, starting, for example, at 30% for individuals and trusts that have held a CGT asset for at least 12 months, moving up 10% every year, until the discount reaches 50% after three years.

Recommendation 6

That existing dividend imputation arrangements remain in place. Dividend imputation is designed to avoid the incidence of double taxation of company profits. To remove dividend imputation, even if accompanied by a substantial reduction in the corporate tax rate, will still leave resident Australian shareholders worse off.

2. Fringe Benefits Tax ('FBT')

2.1 Why does Australia have an FBT regime?

Australia has had a regime designed to tax 'fringe benefits' provided to employees in the hands of the employers that provide them since 1 July 1986.

Prior to the introduction of the *Fringe Benefits Tax Assessment Act 1986* ('FBT Act'), the taxation of non-cash benefits provided to employees was dealt with under S.26(e) of *Income Tax Assessment Act 1936* ('ITAA 1936').

There were numerous deficiencies in the application of S.26(e) of the ITAA 1936 to tax non-cash benefits received by employees from their employers.

It was difficult for employees to determine or ascribe a value to the non-cash benefits that they had received. It was equally difficult for the ATO to know with any degree of confidence what non-cash benefits had been provided to hundreds of thousands of employees.

The challenges faced by the ATO and the Federal Treasury alike when it came to the taxation of non-cash benefits prior to the introduction of a dedicated fringe benefits regime were well articulated by the then Treasurer, the Hon. Paul Keating, in his Second Reading Speech for the package of Bills which introduced Australia's current FBT regime:

> *"Before turning to the main features of the Fringe Benefits Tax, I remind Honourable Members of the background. There has over the years been a very strong movement towards the remuneration of employees - especially higher income earners - by fringe benefits packages which allowed income tax to be avoided on substantial parts of the overall remuneration.*
>
> *So called tax-free perks came to dominate salary package negotiations and packages were openly advertised in the market place. Increasingly innovative deals were emerging particularly after the demise of the "paper" tax avoidance schemes in the early 1980's.*
>
> *All of this was aggravated by the inability of the existing income tax system to exact tax effectively from recipients of fringe benefits. Several factors contributed to this.*
>
> *First there were deficiencies in the income tax law itself. A major one was that it called for case by case subjective judgments to be made as to the value of fringe benefits in the hands of individual employees.*
>
> *That kind of requirement is simply incompatible with the efficient assessment and collection of tax on a mass scale and invites disputation.*
>
> *There were also technical defects creating gaps in coverage, for example, when benefits were given to family members and associates rather than to employees directly.*
>
> *A decided lack of enthusiasm to tackle such problems over the years by previous governments inhibited administrative initiatives in this area, encouraged the growth of fringe benefits and heightened perceptions that there was a right to enjoy perks tax-free once they were negotiated.*
>
> *This was a situation that the Government could not leave unchallenged if tax reform was to have any meaning.*
>
> *Fringe Benefits Tax will be imposed on employers on the taxable value of fringe benefits that they provide to their employees. There is no practical alternative to that course.*"

Paul Keating's comments are as true in 2015 as they were in 1986.

It can readily be seen from the above extract from Paul Keating's Second Reading Speech that the taxing of fringe benefits in the hands of employers is done to achieve fairness and efficiency within the taxation system.

Fairness, because in the absence of taxing benefits in the hands of the employers there was significant non-compliance and a complete failure of S.26(e) of the ITAA 1936 to adequately tax non-cash benefits in the hands of employees. This meant that well-remunerated employees were often structuring their affairs to skew their salary packages in favour of non-cash benefits, which practically speaking, resulted in the avoidance of taxation.

Efficiency, because the least costly method to tax non-cash benefits is to apply the tax at the level of the employers that provide the benefits as opposed to levying the tax on the employees which receive them.

2.2 Should Australia keep its FBT regime?

In recent years, there have been suggestions made by some participants in the tax reform process that the existing FBT regime should be abolished in favour of a regime whereby employees are taxed on the market value of non-cash benefits that they receive.

Such a suggestion, if ever adopted, runs the risk of returning Australia to a regime with all of the pitfalls and shortcomings that were associated with the pre-1986 S.26(e) taxation of non-cash benefits.

Recently released ATO Statistics indicate that for the 2013-14 FBT year, the FBT regime generated approximately $4.1 billion in revenue from 47,510 employers (compared to approximately $3.8 billion in revenue from 48,805 for the 2012-13 FBT year).

It is far more efficient and less costly on the economy as a whole to pursue approximately 50,000 employers for FBT liabilities than it would be to pursue potentially millions of employees for the tax payable on non-cash benefits provided by their employer.

The current FBT regime is well constructed in that it is borne by employers and this makes compliance enforcement and administration much easier for the ATO (because of fewer taxpayers). Moving the taxing point of non-cash benefits to employees would introduce far more 'taxpayers' into the tax system and require a greater devotion of resources to compliance enforcement, thereby creating further inefficiencies in the operation of Australia's tax system.

If, for whatever reason, non-cash benefits were to be taxed in the hands of employees as opposed to how they are currently taxed at the employer level, this would almost certainly necessitate the employer providing detailed information as to the taxable value/market value of non-cash benefits provided to an employee during the course of an income year. It is virtually certain that employees in receipt of these non-cash benefits would be unlikely (or unwilling) to disclose these amounts in their assessable income (as clearly evidenced by the need to abandon S.26(e) and introduce the FBT regime). Such an outcome would have catastrophic implications on the amount of revenue generated on non-cash benefits, representing a fundamental breakdown in the 'integrity' of the tax system.

So assuming a hypothetical tax system where employers do not pay FBT on fringe benefits provided to employees, but rather employees pay tax on the market value of non-cash benefits they receive, there would still be a need for employers to go through a process almost identical to that which they go through now.

That is, employers would still be obliged to have the necessary systems and processes in place to calculate the taxable value (or market value) of non-cash benefits on a per employee basis, so as to ensure that employees disclosed an appropriate amount of non-cash benefits on which they would be subject to personal income tax.

So in this hypothetical scenario, the ongoing need for employers to still calculate the taxable value of non-cash benefits provided to employees achieves next to nothing in terms of removing a compliance burden for employers. Although there would be no FBT liability for an employer to pay, the employer would still be required to undertake the same process that they currently go through when preparing an FBT return to determine the taxable value of benefits provided to employees, on an employee by employee basis.

Where non-cash benefits provided to employees by their employers are to be taxed in the employee's hands, another consideration giving rise to further complexities and red tape, would be whether an employer would be required to collect and remit to the ATO some type of PAYG withholding on these non-cash benefits.

Another advantage of FBT being payable by employers is that it avoids disputes with respect to the amount of tax (or FBT that is payable). Should the taxing point for non-cash benefits be at the employee level, it is not hard to imagine a vociferous army of employees at loggerheads with their respective employers disputing every last detail of the taxable value/market value of non-cash benefits the employer has advised the employee that they have to pay income tax on.

The above consideration of an alternative regime whereby employees are taxed on the market value of non-cash benefits rather than employers, confirms Paul Keating's 1986 Second Reading Speech observation that when carefully considering the taxing of fringe benefits at the employer level, "*there is no practical alternative to that course."*

Employees operating in industries such as building and construction and mining as well as tradespeople would be adversely affected by any attempt to tax non-cash benefits at the employee level.

It is very common for employers operating in these industries to provide an array of benefits (e.g., car fringe benefits and benefits associated with travelling to distant work locations) that introduce no direct taxing point to the particular employee under the current regime for taxing non-cash benefits. Very often these benefits are not "salary sacrificed", meaning that the associated FBT liability triggered by the provision of these benefits does not reduce the employee's after-tax cash salary.

However, transferring the taxing point on non-cash benefits will create an inequity in our tax system by placing the tax burden onto the employee whereas previously it was shouldered by the employer.

Similarly, sales representatives and regional managers would also be severely affected by any such proposal to tax non-cash benefits at the employee level. These employees are frequently provided with cars by their employers (almost as a tool of trade) where the employee receiving the tool of trade vehicle suffers no reduction in their after-tax cash salary (that is, there is no salary sacrifice agreement). Taxing these employees for any private use of these vehicles would create a severe inequity in the tax system by, again, placing the tax burden onto the employee whereas previously it was shouldered by the employer.

2.3 Should the FBT year, currently ending 31 March, be changed?

Since the introduction of the FBT regime as of 1 July 1986, the FBT year has ended on 31 March. This is a hard-wired year-end, meaning that it applies to all employers and it is not possible to have a 'substituted accounting period' as is possible for taxpayers in relation to income tax.

The NTAA view is that having an FBT year-end of 31 March is a positive feature of the FBT regime, as it allows taxpayers to have more 'control' over their FBT and other tax obligations.

Aligning the FBT year-end to the income tax year-end of 30 June would create numerous difficulties for employers and tax agents. Employers, be they large or small, often have financial account preparation obligations that commence almost immediately after the income year has finished. Placing yet another obligation in the post-income tax year-end period is not desirable.

Moreover, employers need to issue PAYG Payment Summaries to their employees by 14 July. The PAYG Payment Summary, where applicable, needs to disclose an employee's Reportable Fringe Benefits Amount ('RFBA'). It is only at the end of the FBT Return process that an employer has the requisite information to determine RFBA values for PAYG Payment Summaries.

Therefore, it would be almost impossible to commence and complete the process of calculating RFBA disclosures within 14 days of their income year end and issue a PAYG Payment Summary to an employee (as required by the law). This is what would be required if the FBT and income year were aligned for taxpayers that did not have a substituted accounting period for income tax purposes.

2.4 Potential areas of improvement

Some criticisms often made of the existing FBT regime is that the associated documentation and evidentiary requirements are often complicated and time consuming. With this in mind, consideration should be given to the simplification of FBT documentation requirements and the use of 'safe harbours' when applying various exemptions or reductions in the taxable value of fringe benefits.

2.4.1 'Safe harbours' for exemptions/reductions in taxable value

A recent development for which the NTAA commends the ATO is the establishment of the FBT Safe Harbour Working Group, comprised of ATO representatives and external representatives.

The FBT Safe Harbour Working Group is a consultative body which aims to provide employers with some safe harbours that the ATO will generally accept in various scenarios when an employer is seeking to access an exemption or a reduction in taxable value of a particular fringe benefit.

There is much fertile ground for the FBT Safe Harbour Working Group to explore, so as to help provide certainty and to reduce complexity for employers in relation to FBT.

2.4.2 Modernisation of the existing FBT Act

A much appreciated feature of more recent examples of tax-related legislation, such the *Income Tax Assessment Act 1997* and *A New Tax System (Goods and Services Tax) Act 1999* is the use of asterisks to denote defined terms.

Unfortunately, the *Fringe Benefits Tax Assessment Act 1986* ('the FBT Act') does not use asterisks to denote defined terms.

It is also noted that not all defined terms within the FBT Act are contained within the 'dictionary' section in S.136.

It would assist with the reading and in the correct interpretation of the FBT Act, if all defined terms could be placed in S.136 and if defined terms are denoted by an asterisk as they appear throughout the FBT Act.

2.4.3 Streamlining valuation methodologies for various types of benefits

There are often numerous methods available within the FBT Act for an employer to choose from to determine the taxable value of a fringe benefit.

Considering 'car-parking benefits' as an example, there are three different ways to determine the number of car parking spaces an employer has provided its employees. There are also three different ways to determine the value of these underlying car parking spaces. Broadly speaking, the taxable value of a car parking benefit is a function of the number of spaces provided and the value of those spaces.

Whilst in some areas choice of valuation methodology is welcomed by taxpayers (for example, when valuing meal entertainment benefits, employers have access to the actual method, the 50/50 split method and the 12-week register method), in some other areas the amount of choice can be cause of confusion and complexity for taxpayers.

Consideration should be given as to whether there are instances within the FBT legislation where valuation methodologies could be simplified, so long as this does not lead to a compromise on fairness.

For example, in relation to car parking fringe benefits, consideration could be given to removing the least-often used methods (of the three currently available) to determine both the number of spaces provided and the value of these spaces.

In relation to 'in-house' property fringe benefits, broadly speaking, there are currently different valuation methods depending on whether the employer is a retailer or a manufacturer of the benefit provided. A further complicating factor for an employer that is a manufacturer, is whether the goods are sold in the wholesale or retail market. Consideration could be given simplifying the valuation of in-house property benefits by replacing the various existing valuation rules with principle that the taxable value of an in-house property benefit is determined with reference to the cost to the employer of providing the benefit.

2.5 Conclusions and recommendations regarding FBT

The current FBT regime, although not perfect, is well structured, providing both a fair and efficient means of taxing non-cash benefits provided to employees.

Attempts to move the burden of taxing non-cash benefits from employers to employees will result in a far less efficient process of taxing non-cash benefits. Such attempts would also fail to deliver any fairness to those employees, where the very nature of their employment is such that they receive substantial non-cash benefits.

Recommendation 7

That the taxation of non-cash benefits provided to employees remains a tax payable by employers under the FBT rules as this is the fairest and most efficient way of taxing non-cash benefits.

Recommendation 8

That measures to simplify the documentation, evidentiary and paperwork requirements relating to FBT for employers be explored. The ATO's recently created FBT Safe Harbour Working Group is a good start to the commencement of this process.

Recommendation 9

That the FBT year-end of 31 March remains unchanged. The differentiation between the FBT and income tax year-ends allows for employers and tax agents to stagger their workloads.

Recommendation 10

The FBT Act should be modernised such that asterisks are used to denote defined terms throughout the Act and ideally all defined terms are contained in the 'dictionary' section of the Act.

Recommendation 11

Consideration should be given as to whether there are instances within the FBT legislation where valuation methodologies could be simplified, so long as this does not lead to a compromise on fairness.

For example, in relation to car parking fringe benefits, consideration could be given to removing the least-often used methods (of the three currently available) to determine both the number of spaces provided and the value of these spaces. As a further example, consideration could be given to simplifying the valuation of in-house property benefits.

3. Administration

An overarching concern relating to the administration of the tax system by the ATO is the way it can be improved so as to achieve reductions in red tape obligations.

The term 'red tape' can take on many meanings and manifest in different ways. An example of red tape may include inconsistencies between different taxpayers' interaction with the ATO leading to confusion and uncertainty amongst taxpayers. Other examples include increased time and resources which may need to be devoted to dealing with the ATO on matters which should not have manifested if the ATO administration of the tax system was improved.

Just as the design of a tax system needs to be guided by the objectives of efficiency, integrity, simplicity, fairness and revenue adequacy, so too does any discussion on suggested improvements relating to its administration.

The following discussion and ensuing recommendations are some examples where we believe improvements to, or modification of, the administration system may be warranted to achieve the state goals above.

3.1 Inconsistencies in the application of the law – Private Binding Rulings

It is not uncommon for the ATO to provide inconsistent Private Binding Rulings ('PBRs') in relation to scenarios where different taxpayers have almost identical facts.

To be fair to the ATO, it no doubt tries its absolute best to have robust and thorough processes in place when it comes to issuing PBRs. Given the sheer volume of PBRs issued every year it is inevitable that inconsistencies will arise.

It is reassuring that, for transparency, sanitised versions of PBRs (with reference to the underlying taxpayer being removed) are placed on the ATO's Register of PBRs, which is available to be searched on the ATO's website. The ATO is commended for ensuring its PBRs are available for public scrutiny in this way.

Nevertheless, there is still a need to improve the overall quality and consistency of PBRs. Improved training of ATO staff in this area and the further development of specialisations amongst those ATO staff charged with the responsibility of writing PBRs might assist with this area of development.

By improving the overall quality of the PBR process the objectives of efficiency, fairness and integrity will be enhanced.

3.2 Length of PBR process

The ATO states that it aims to provide a completed PBR within 28 calendar days of receiving all necessary information.

It is readily appreciated that many PBRs involve complicated sets of facts and equally complicated technical matters. Often the ATO will need to ask the taxpayer (or their tax agent) for additional information before a PBR can be finalised.

Nevertheless, our members routinely advise us of instances where close to the 28th calendar day since the tax agent last provided information to the ATO, that yet another request for information is received, where the benefit of the information requested is questionable.

Even where these ongoing information requests are considered to be reasonable by the tax agent, a PBR request can often take many months to complete as measured from when it is first submitted to the ATO until when it is finally issued to the taxpayer.

Ongoing monitoring by the ATO of PBR requests taking longer than 56 days and the reasons why PBRs are progressing slowly might help assist in improving efficiency in this area.

3.3 Pushing clients to PBRs as front line staff have insufficient training/knowledge

Whilst appreciating the ATO does its best in terms of over-the-phone tax technical assistance to tax agents through its 13 72 86 Tax Agents Services Line, there are many shortcomings in the assistance provided.

Clearly, there will be many questions raised by tax agents that simply do not lend themselves to a 'Yes/No' type answer, or an answer that is clear cut.

Whilst appreciating the challenges of providing such assistance to tax agents in relation to the application of the tax law, the NTAA is often advised by its members of instances where a relatively straight forward question is presented to the ATO and several different responses are given by different staff.

Another common observation made by our Members is that ATO staff often default to the response "best apply for a Private Binding Ruling" on the Tax Agents Services Line.

Whilst appreciating that in many instances a PBR is the best way to obtain with certainty the ATO view on a particular tax question, a concern held by many of our members is that this response is often used simply to shut down a conversation when an ATO staff member does not have sufficient tax technical expertise to answer the tax agent's query.

Again, better training of frontline ATO staff who provide this valuable service for tax agents by servicing the 13 72 86 Tax Agents Services Line, could help improve the overall efficiency of the administration of the tax system.

3.4 Inconsistencies with debt arrangements offered to taxpayers

Our members also advise us that, when representing taxpayers that have fallen behind in paying their tax debts and are in need of a debt payment arrangement with the ATO, it is not uncommon for a tax agent and/or taxpayer to speak to different ATO staff and receive verbal offers for widely varying debt repayment arrangements. Our members advise that upon receiving an unfavourable offer they simply call the ATO back again, hoping to receive a better offer from a different ATO staff member.

This is another example of inconsistencies within the ATO when it comes to the administration of tax law.

Increased training of ATO staff and better computer systems in the debt management area might assist in consistency of offers made by ATO staff to taxpayers in need of a debt arrangement.

3.5 ATO expectations for information turnaround by taxpayers/tax agents

When dealing with taxpayers that are the subject of an audit, the ATO routinely makes information requests of taxpayers, often through their tax agents, for additional information or copies of tax invoices or other documents. The requested time frame to respond to such requests can be as short as seven days from the date of the letter making the request.

These time frames are often very unrealistic, especially when it is considered that a few days might be lost during the postal process and that relevant documents are sometimes kept off-site and a myriad of other factors.

To be fair to the ATO, the ATO officers making such requests routinely grant extensions of time to comply.

However, these information requests are occasionally surrounded by discussions of potentially adverse findings from the audit, should the information sought by the request not be provided within the time frame insisted upon by the ATO.

It would assist in the fairness of the administration of the tax system if the time frames proposed by the ATO in such information requests were to be a little more flexible.

3.6 ATO correspondence with tax agents and taxpayers

There are several areas of concern relating to confusion caused by the ATO in its communication, either over the phone or in writing, with taxpayers and tax agents alike.

One such example is where a taxpayer uses the services of a tax agent but for whatever reason the ATO sends correspondence directly to the taxpayer as opposed to the tax agent. Similarly, our members advise that in some instances the ATO has been known to directly contact taxpayers on the phone instead of calling the tax agent.

Taxpayers engage the services of a tax agent to represent them in dealings with the ATO. It generates inefficient double-handling where the ATO contacts a taxpayer in the first instance and then ends up being directed to contact the taxpayer's tax agent.

A particularly concerning example of the failures of ATO communication experienced by one of our members is as follows:

A tax agent's client was a newly created discretionary trust undertaking a property development. The trust was registered for GST and had lodged its first Business Activity Statement ('BAS'). Being the first BAS after the acquisition of land for which there was a large claim for a refund of input tax credits, the ATO understandably contacted the tax agent with a request for more information, including the relevant contract relating to the land acquisition and a tax invoice. The ATO gave the tax agent seven days to provide this information. The tax agent, after discussing the matter with the client, agreed to this request. However, after contacting the tax agent but before the expiration of the seven day period, the ATO contacted the client directly over the phone advising that if the contract and tax invoice were not provided by close of business that very day, the claim for input tax credits would be denied and the taxpayer would be subject to penalties for making a false or excessive claim.

Ensuring that the ATO has clear procedures and protocols in place when contacting taxpayers, either by phone or in writing, especially where the taxpayer has a tax agent, would help reduce inefficiencies in this area.

3.7 ATO overreach when using data matching and proposing amended assessments

Another concern our organisation holds is the use of electronic data harvesting to generate letters threatening an amended assessment, where the underlying assumption of the ATO's letter writing campaign – that a deduction was incorrectly claimed, or that income was omitted – is found to be incorrect.

In October 2014, the ATO sent letters to numerous individual taxpayers with rental properties indicating that the taxpayer may have incorrectly claimed deductions for borrowing expenses.

In every single instance that was brought to our organisation's attention, the taxpayer's original claim for borrowing expenses was correct to the cent.

A concern with the format of the letter was that if no response was provided within a month of the letter's date, the ATO would automatically issue an amended assessment denying a deduction for correctly claimed borrowing expenses.

Another example brought to the NTAA's attention was a letter writing campaign based on ATO data matching, presumably with State Revenue Offices and Land Titles Offices, focusing on

capital gains that were allegedly not disclosed from the sale of real estate. The letters identified an alleged omitted capital gain and threatened to issue an amended assessment with a liability for income tax triggered by the alleged capital gain which would often be tens or hundreds of thousands of dollars. In numerous instances the properties that were the subject of these ATO letters were completely covered by the main residence exemption (i.e., no error had been made from a CGT perspective). In some scenarios, taxpayers who had the same name as a different person, were falsely accused of disposing of an asset that was their namesake's.

These poorly targeted letter writing campaigns where the recipient taxpayer has not made a mistake in their originally lodged return, generate significant amounts of needless red tape for taxpayers and tax agents. Tax agents may need to spend hours liaising with the ATO and the taxpayer to bring the issue to a close.

It is appreciated that there will be numerous instances where these types of letter writing campaigns, especially about omitted information, are an appropriate and efficient way to administer the tax system (e.g., omitted interest income).

However, in the interests of fairness, these letter writing campaigns suggesting that an automatic amended assessment will be issued if the taxpayer does not contact the ATO within a given timeframe, should not be used unless the ATO has a high degree of certainty as to the alleged mistake in the originally lodged return (as would be the case with omitted interest income).

3.8 Conclusions and recommendations regarding administration

Recommendation 12

That the quality and consistency of Private Binding Rulings ('PBRs') be improved by providing ATO staff involved in the process of issuing PBRs with improved training. By improving the quality of the PBR process the objectives of efficiency, fairness and integrity are enhanced.

Recommendation 13

Measures to improve the turnaround time of PBRs should also be considered.

Recommendation 14

That the ATO provide improved tax technical training to its frontline staff who operate the ATO's Tax Agent Services Line, 13 72 86.

Recommendation 15

That when seeking information from both tax agents and taxpayers as part of a review/audit process, the ATO applies fair and reasonable timeframes for the provision of requested information.

Recommendation 16

That the ATO has clear procedures in place when communicating with taxpayers (either in writing or over the phone) and that wherever possible, where a taxpayer is represented by a tax agent, the tax agent should be the appropriate communication point unless the client has agreed to an alternative arrangement. That communication directly between the ATO and taxpayers does not result in an outcome more favourable than that achieved via communication between the ATO and a tax agent (e.g., remission of penalties and interest).

Recommendation 17

That the ATO acts in a cautious and considered manner in its application of electronic data mining techniques as the basis of sending letters to taxpayers indicating that an amended assessment will be issued. The ATO should have a high degree of certainty as to the existence

of an alleged mistake in a taxpayer's return before sending out a letter indicating an amended assessment is imminent.

4. Superannuation and other matters

The very essence of superannuation is that it is a tax-privileged environment designed to encourage individuals to save for their retirement.

The NTAA acknowledges that there is a desire to better target the concessions that are available for savings being directed into superannuation and the payment of these amounts (as either lump sums or pensions) once a taxpayer has met a condition of release.

Over the last decade, there have been substantial changes made to the legislative framework surrounding superannuation. Whilst it is naïve to think it possible that superannuation can be an area of tax law the does not change, there is certainly a level of scepticism amongst tax agents and taxpayers that is now associated with superannuation planning, given the perceived uncertainty of the legislative environment.

Tax agents and taxpayers are becoming increasingly concerned with the willingness of governments to make amendments to the rules and this is not promoting confidence in the superannuation system.

4.1 Tax-free status of funds in pension phase

Currently, to the extent that a superannuation fund's assets support a pension interest, the earnings on the assets in pension phase are tax-free. Generally, to the extent a fund is in accumulation phase, the earnings on assets in accumulation phase are taxed (less relevant deductions) at 15%.

Currently, so long as a superannuation fund member is 60 or over, lump sum payments and pension payments they receive are tax-free.

We believe that amendments are not required to reduce/remove the pension asset exemption for assets used to support the payment of a pension within a fund. In fact, we believe that urgent Government dialogue is needed to reassure tax agents and taxpayers that this exemption will not be tampered with. We are concerned that constant speculation has created scepticism within the superannuation industry regarding the long term survival of this exemption and this is starting to affect how clients are providing for their retirement. Certainty is needed on this issue so that taxpayers can plan for their long term retirement.

4.2 Actuary's Certificates

An actuary's certificate is required under existing legislation by a superannuation fund, including a self-managed superannuation fund ('SMSF'), where a fund is partially in pension phase and partially in accumulation phase and has not 'segregated' its assets.

An actuary's certificate is a statement from a qualified actuary advising the trustee of the fund as to the proportion of fund income that is tax-free.

Where a fund requires an actuary's certificate, there are currently no exemptions to this requirement.

Consideration should be given to the introduction of a *de minimis* rule whereby an actuarial certificate is not required for SMSFs in both pension and accumulation phase where the balance of entitlements within the SMSF is below a particular threshold.

4.3 Ten year document retention requirements

Trustees of superannuation funds are required to keep minutes of all meetings for at least ten years.

This ten year time frame is lengthier than other time frames associated with documentation retention in other areas of tax.

Consideration should be given to whether the document retention period for the minutes of meetings of trustees could be reduced. A suggested appropriate period would be five years.

4.4 Superannuation – Limited Recourse Borrowing Arrangements – ATO inconsistencies

In 2014 the ATO issued Interpretative Decisions 2014/39 and 2014/40, which broadly speaking, cast grave doubt as to the efficacy of limited recourse borrowing arrangements ('LRBAs') where a self-managed superannuation fund was borrowing from a related party and being charged no interest or below market rate interest.

These Interpretative Decisions may well represent the correct technical view on this contentious area, but disappointingly the ATO had previously provided (non-binding) guidance in the form of the minutes of the Superannuation technical sub-committee meeting of the ATO's National Tax Liaison Group on 5 June 2012, which indicated 'low' or 'no' interest loans did not create the problems raised by the 2014 Interpretative Decisions. Numerous PBRs also followed the approach outlined by the ATO in the 5 June 2012 minutes (acknowledging that a PBR only ever binds the Commissioner to the taxpayer to which it was issued).

It is to be hoped that the ATO takes into account its previously provided (non-binding) guidance on this matter when considering the tax consequences for SMSFs that may have entered into LRBAs with low or no interest loans, where such arrangements were entered prior to its later change of view, as reflected in the 2014 Interpretative Decisions.

It is important that when the ATO provides guidance as to the operation of the *Superannuation Industry (Supervision) Act 1993* and the operation of income tax legislation pertaining to the taxations of superannuation funds, that it provides clear and consistent guidance.

Where the ATO changes a previously held position relating to the application of tax law, wherever possible it should allow taxpayers that entered into arrangements prior to a new position being made public, ongoing reliance on the ATO's former position, so long as the arrangement entered into prior to the new view being made public remains in place.

4.5 Superannuation – Concessional contributions capping thresholds

For the 2015 income year the concessional contributions capping threshold is $30,000 for individuals of less than 50 years of age, and $35,000 or individuals aged 50 years or over.

The concessional contributions cap for individuals aged 50 years or over was $100,000 for the 2008 and 2009 income years. It was then dropped to $50,000 for the 2010, 2011 and 2012 income years.

Individuals aged in their 50s often find, as they draw closer to their retirement, that they are now in a position to make additional contributions to their superannuation, that were simply not possible when they were younger (due to financial pressures such as paying off a mortgage over their main residence, raising children, etc.).

It seems strange that the difference between the concessional contributions capping threshold for individuals aged 50 or over compared to the capping threshold for individuals aged under 50, is currently only $5,000.

To enable individuals to better prepare and save for their own retirement, consideration should be given to raising the concessional contributions capping threshold for individuals aged 50 or over. A suggested level is $60,000.

4.6 A uniform definition of 'employee'

Across income tax legislation, FBT and the *Superannuation Guarantee (Administration) Act 1992*, there are different definitions of the term 'employee'.

Moreover, Commonwealth legislation in relation to industrial relations matters, such as the *Fair Work Act 2009* and various State and Territory legislation in relation to pay-roll tax and workers compensation insurance all contain their own definitions of 'employee'.

The definition of 'employee' and the so-called employee/contractor dichotomy are of vital importance to the administration of the tax system.

Broadly speaking, employees based on the common law understanding of this term, or employees under the 'extended-definition' based on statutory definitions, will generally be the subject of various obligations owed to them by their 'employers'. On the other hand, 'genuine' contractors not falling within the definition of 'employee' are not generally owed these obligations from their clients. For example, payments to an 'employee' will be subject to PAYG withholding owed by their employer to the ATO. Payments to a 'genuine' contractor (assuming the contractor has a valid ABN) are, generally speaking, not subject to PAYG withholding.

Employers with the very best of intentions often make mistakes due to the uncertainty surrounding who is an 'employee', frequently giving undue consideration as to whether a person has an ABN or not.

The consequences of these mistakes are financially burdensome, and in some cases, even ruinous.

For example, where an employer has failed to make PAYG withholding payments on cash payments to an 'employee' they can be subject to a penalty equal to the amount they did not withhold.

Whilst an ambitious project, consideration should be given to exploring ways by which the definition of 'employee' could be harmonised amongst various Federal tax and superannuation legislation. Furthermore, consideration should also be given to an initiative whereby States and Territories are also involved in the project of harmonisation in relation to the definition of employee. Where a taxpayer operates their business in numerous states and territories throughout Australia, the need to become familiar with multiple definitions of 'employee' in multiple jurisdictions in order to correctly comply with income tax, FBT, superannuation, work cover and pay-roll tax becomes very burdensome.

Consistency in relation to the definition of 'employee' would result in a significant reduction in red tape and complexity for employers.

4.7 Conclusions and recommendations regarding superannuation and other matters

Recommendation 18

The ongoing entitlement of superannuation funds (including SMSFs) to claim income tax and CGT exemptions should be confirmed to restore 'fairness' and 'simplicity' to these rules. The current level of uncertainty is undermining the tax system in relation to this issue.

Recommendation 19

Consideration should be given to the introduction of a *de minimis* rule whereby an actuarial certificate is not required for SMSFs in both accumulation and pension phase where 'segregation' is not used and where the balance of entitlements within the SMSF is below a particular threshold. As an alternative, trustees should be able to apply a simple mathematical calculation based on an average of balances in accumulation and pension phase.

Recommendation 20

Consideration should be given to whether the document retention period for the minutes of meetings of trustees could be reduced. A suggested appropriate period would be five years.

Recommendation 21

To enable individuals to better prepare and save for their own retirement, consideration should be given to raising the concessional contributions capping threshold for individuals aged 50 or over. A suggested level is $60,000.

Recommendation 22

Where the ATO changes a previously held position relating to the application of a tax law, especially in relation to superannuation matters, wherever possible it should allow taxpayers that entered into arrangements prior to the new position being made public, ongoing reliance on the ATO's former position, so long as the arrangement entered into prior to the new view being made public remains in place.

Recommendation 23

Consideration should be given to exploring ways by which the definition of 'employee' could be harmonised amongst various Federal tax and superannuation legislation. Furthermore, consideration should also be given to an initiative whereby States and Territories are also involved in the project of harmonisation in relation to the definition of 'employee'. The need for businesses that operate in more than one state or territory to become familiar with multiple definitions of 'employee' pertaining to numerous taxes and employer obligations is an example of overly burdensome red tape that needs to be addressed.