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AUSTRALIA + NEW ZEALAND

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The Manager
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The Treasury
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Review of the Register of Approved Occupational Clothing and related tax deductions – Discussion paper

Dear Madam/Sir

Thank you for the opportunity to provide a submission regarding the discussion paper on the Review of the Register of Approved Occupational Clothing and related tax deductions.

The options for non-compulsory uniform provisions

The discussion paper is reviewing the income tax treatment of non-compulsory uniforms as they are due to sunset on 1 April 2017.

The stated purpose of the review is to determine whether the tax treatment "remains fit for purpose, necessary and relevant". The discussion paper raises concerns about the level of detail and the prescriptiveness of the current regime. Four options are canvassed in the discussion paper:

1. Reissue the current guidelines
2. Simplify the guidelines
3. Repeal the guidelines and rely on the general deduction provision of the Income Tax Assessment Act 1997 (**ITAA 1997**)
4. Deny all tax deductions for non-compulsory uniforms.

Our view

Chartered Accountants Australia and New Zealand (**Chartered Accountants**) considers that the current non-compulsory uniform provisions are no longer fit for purpose, and are neither necessary nor relevant for the reasons outlined below.

On balance, we support option 3.

We do not support option 1 because we believe the current law can be simplified. The current regulatory framework may also be being ignored by some business taxpayers.

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Option 2 would be an improvement on the existing situation which we would also support were it not for the continued involvement of multiple government agencies.

Option 4 has some appeal in that it seeks to draw a line between private and business expenditure. However, we do not support piecemeal tax reform of work-related expenses, and prefer instead a more comprehensive approach to the topic with accompanying trade-offs for individual taxpayers.

Our thinking is set out in more detail below.

Division 34 increases complexity and is ignored by some

Regulation is not intrinsically bad: it can be a useful means of providing simplification and certainty to an unsettled area of the tax law. However, the non-compulsory uniform legislation and guidelines do not provide this benefit.

To claim a deduction for a non-compulsory uniform an individual taxpayer must navigate section 8-1 of the ITAA 1997 – the general deduction provision – and then the provisions of Division 34 ITAA 1997 and the associated guidelines.

In our view, Division 34 and the associated guidelines add an unnecessary layer of complexity to the existing tax law and require involvement of a regulator other than the Australian Taxation Office (**ATO**).

The prescriptiveness of Division 34 and the guidelines misleads some taxpayers and advisers into thinking that a deduction is available without reference to section 8-1.

The proposed simplified guidelines for option two (contained in Appendix One of the discussion paper) are to be commended for adopting an 'in principle' approach rather than a prescriptive approach to defining what could qualify for a non-compulsory uniform deduction. For example, rather than specifying the number of colours used and size of identifiers, there would just be a requirement that there be a plainly visible distinctive pattern that is recognisable by the public as relating to the employer, product or service – that is, it is used in the same way as advertising.

Unfortunately, even the simplified guidelines still require non-compulsory uniforms to be included in the Corporate wear Register[1]. It is not clear to us why this is still required in an era of taxpayer self-assessment, especially given the discussion paper notes that "the register is not publicly available online and as such is not easily accessible for employees who need to find out whether they can deduct their non-compulsory uniform"[2]. Nor does the involvement of another government agency seem appropriate at a time when the government is looking to reduce red tape and costs.

We also hear from our members that there are many employers nowadays who do not register their uniforms at all – the employers directly approach the large number of corporate uniform suppliers with their own designs and provide the apparel to their staff. Increasingly, such apparel is for compulsory use but in practice, the distinction between compulsory and non-compulsory use can be unclear, particularly in the small business sector where workplace policies are rarely documented.

[1] It is noted that whilst the original design needs to be registered, there no longer appears to be a requirement that variations to the design have to be registered. This may cause confusion as to what is a variation and what is a new design.
[2] The rest of this quote is "Employees must therefore rely on their employers to notify them whether or not their non-compulsory uniform is registered; or phone the Department of Industry, Innovation and Science to find out themselves."

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In either case (compulsory or non-compulsory uniform), we hear that employers nowadays generally regard the apparel as a form of corporate advertising and brand association, with many providing the clothing as a tax free fringe benefit.

Some businesses also see such clothing as a means of identifying staff (i.e. for workplace safety or security purposes, and for customers to identify).

Inconsistent with self-assessment

At the time Division 34 and the guidelines were introduced, it was noted that the prescriptiveness of the requirements were inconsistent with self-assessment[3]. This is still true today.

Chartered Accountants agrees with the comment in the discussion paper that "there does not appear to be a sound policy rationale for this level of prescription and the additional regulatory costs it would continue to impose".

Register does not assist the ATO, tax agents or employees

The use of a register for non-compulsory uniforms does not assist enforcement of laws by the ATO, nor compliance by tax agents for their clients or by individual self-lodgers. This is because:

- "The register is not publicly available on-line and as such is not easily accessible for employees who need to find out whether they can deduct their on-compulsory uniform."[4]
- The ATO needs to identify and scrutinise individual tax returns that have a clothing deduction. This scrutiny generally occurs by benchmarking a taxpayer's work expense claims against others in similar occupations. Very few employee returns are audited by the ATO.

The original purpose of Division 34

The discussion paper notes that – when these rules were initially announced in the 1992-93 Federal Budget and the legislation was first introduced to Parliament – it was proposed that **all** deductions for non-compulsory uniforms were to be denied "to ensure that the tax laws do not confer an unfair advantage on some employees by permitting deductions for clothing which may not be essentially different from that worn to work by other employees for which no deductions are allowed" [5]. We recall that in those days there was a justifiable concern that employers were providing salary sacrifice corporate wardrobe plans for office workers where the apparel contained little, if any, branding relating to the employer's business.

Prior to the legislation being passed by Parliament, amendments were made. These amendments allowed non-compulsory uniforms to continue to be deductible provided that the additional requirements contained in the current law were satisfied. The discussion paper notes that:

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[3] Source: http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;db=CHAMBER;id=chamber%2Fhansardr%2F1992-11-10%2F0040;query=Id%3A%22chamber%2Fhansardr%2F1992-11-10%2F0019%22

[4] Paragraph 16 of the Treasury discussion paper.

[5] Source: http://www.austlii.edu.au/au/legis/cth/bill_em/tlab61992285/memo_0.html

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> *These amendments came at a time when the then Government was investing considerable efforts and funds via the then Textile, Clothing and Footwear Development Authority (TCFDA) in a structural adjustment package, deemed necessary to counter the shocks form the significant downward adjustments in protective tariffs for those industries. Textile and clothing tariffs were scheduled to be progressively reduced from 55 per cent in 1990 to 25 per cent in 2000. The tariff rate has since been reduced to 5 per cent for these goods.*

The above analysis suggests the policy rationale for Division 34 at the time it was introduced is no longer valid. And with suitable ATO guidance, we think it can be made clear to employers that the branding of non-compulsory uniforms must be sufficiently distinctive.

Problems associated with reforming work related deductions

The discussion paper states that option four – denying tax deductions for non-compulsory uniforms – "is canvassed for completeness, although it would not address the objective of ensuring that deductions are not available for non-compulsory uniforms in cases where the clothing is clearly identifiable as corporate wardrobe".

We acknowledge that Australia treats non-compulsory uniform costs differently to other jurisdictions. Canada and the United Kingdom only allow deductions for compulsory uniforms and protective clothing – not non-compulsory uniforms[6]. Given the amount of complexity surrounding non-compulsory uniforms, some would argue it is time to revisit the policy rationale for allowing the deduction for non-compulsory uniform deductions in Australia.

However, Chartered Accountants does not support piecemeal tax reform on workplace deductions.

We note that earlier this year the House of Representatives Standing Committee on Economics conducted an inquiry into the tax deductibility of work related deductions generally. The Committee has yet to report its findings. The Chartered Accountants' submission[7] to this inquiry highlighted a number of issues, and in relation to clothing, we quoted the following extract from an article by Jonathan Baldry[8] urging reform (references are to ATO public rulings published at the time the article was written):

> *"For example, a shearer may claim deductions for jeans used as working clothes (TD 94/48), even though many people buy and wear jeans, and many shearers would buy them as non-working clothes. By contrast, the clothes worn by plain-clothes police officers are not allowable deductions (TR 95/13). Flight attendants, required to be well groomed on the job, cannot claim personal grooming expenses (TR 95/19) (as distinct from moisturisers, hair conditioners and the like, which are allowable deductions in recognition of the harsh working environment), while physical training instructors are able to claim the off-the-job costs of keeping fit, which is a necessary requirement for their occupation (TD 93/110)."*

Baldry argues that this approach produces "arbitrary and inequitable" outcomes. It is hard to disagree.

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[6] Canada: http://www.cra-arc.gc.ca/tx/bsnss/tpcs/pyrll/bnfts/prvdd/clthng-eng.html
United Kingdom: https://www.gov.uk/expenses-and-benefits-clothing/overview

[7] Submission number 11 at http://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/Tax_deductibility/Submissions

[8] Jonathon Baldry, Abolishing Income Tax Deductions for Work-Related Expenses, Agenda, Vol., No.1, 1998, pages 49-60. Available from : http://press-files.anu.edu.au/downloads/press/p104931/pdf/article05.pdf

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Our submission also noted that it takes a 25 page public ruling[9] for the ATO to explain the general principles flowing from the legislation and judicial decisions on the deductibility of clothing, uniforms and footwear, with this ruling backed up by even more public rulings on clothing for specific occupations.

A 'clean slate' approach to reforming the tax deductibility of work related expenses would be to deny such deductions outright - subject to compensatory measures such as a reduction in the personal tax rate or a fixed personal allowance recognising the deductions foregone[10]. This would have the benefit of making the income tax law simpler and arguably more equitable as Australia's progressive income tax scales also enhance the value of tax deductions in proportionate terms as taxpayers move into higher tax brackets.

However, the provision of safety and occupation specific workplace clothing under both the income tax and FBT law would also need to be considered as part of any such reform.

Currently, employers can provide certain categories of clothing to employees, and provided the clothing would be otherwise deductible to the employee, the amount of FBT payable is nil. Alternatively, the provision of workplace clothing may be eligible for the minor benefit exemption. In either situation, given that it is the employer that is liable for FBT and the benefit is exempt income in the hands of the employee, it becomes necessary for any income tax reform to workplace clothing deductions to be considered in tandem with FBT reform. Otherwise, different outcomes arise for employees depending on the fringe benefit policies of their employers.

We also mention for completeness the various industrial awards and workplace agreements which may contain specific rules for the provision and maintenance of uniforms. This throws up another point of differentiation between employees in similar roles and earning similar incomes: those covered by such awards or agreements and those who are not.

Suggested approach

In the absence of any such comprehensive reform process, the best way forward that we can see is to simplify the current rules by:

- Repealing Division 34 as a red-tape reduction measure.
- Asking the ATO to publish revised guidance which makes clear the characteristics of a non-compulsory uniform, including the need for distinctive logos etc. This guidance would also state clearly the income tax deduction entitlements associated with such apparel.
- Considering a mechanism whereby the status of uniforms worn by employees (workplace safety, occupation specific, compulsory or non-compulsory) could be confirmed by a code shown on each employee's electronic PAYG annual payment summary.
- Revising ATO guidance on the application of the FBT otherwise deductible rule to a property benefit or a residual benefit comprising the provision of a compulsory or non-compulsory uniform to an employee. Where the otherwise deductible rule is

[9] TR97/12 https://www.ato.gov.au/law/view/document?DocID=TXR/TR9712/NAT/ATO/00001
[10] Which would also assist in reducing the incentive to use corporate structures to 'park' profits.

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unavailable, the guidance should also address the application of the minor fringe benefit rule (the minor benefit rule is already frequently invoked for benefits such as the provision of an employer-branded t-shirt for staff sports days, or a branded umbrella given to employees for their personal use).

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I would be happy to discuss any aspects of our submission with you. I can be contacted on (02) 9290 5609 or by email at: michael.croker@charteredaccountantsanz.com

Yours faithfully,

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Who we are

Chartered Accountants Australia and New Zealand is a professional body comprised of over 120,000 diverse, talented and financially astute members who utilise their skills every day to make a difference for businesses the world over.

Members are known for their professional integrity, principled judgment, financial discipline and a forward-looking approach to business which contributes to the prosperity of our nations.

We focus on the education and lifelong learning of our members, and engage in advocacy and thought leadership in areas of public interest that impact the economy and domestic and international markets.

We are a member of the International Federation of Accountants, and are connected globally through the 800,000-strong Global Accounting Alliance and Chartered Accountants Worldwide which brings together leading Institutes in Australia, England and Wales, Ireland, New Zealand, Scotland and South Africa to support and promote over 320,000 Chartered Accountants in more than 180 countries.

We also have a strategic alliance with the Association of Chartered Certified Accountants. The alliance represents 788,000 current and next generation accounting professionals across 181 countries and is one of the largest accounting alliances in the world providing the full range of accounting qualifications to students and business.