

CCI Submission to the *Review of Aspects of Income Tax Self Assessment*

About CCI

The Chamber of Commerce and Industry of Western Australia (CCI) is the leading business association in Western Australia.

It is the second largest organisation of its kind in Australia, with a membership of 5,000 organisations in all sectors including manufacturing, resources, agriculture, transport, communications, retailing, hospitality, building and construction, community services and finance.

Most members are private businesses, but CCI also has representation in the not-for-profit sector and the government sector. About 80 per cent of members are small businesses, and members are located in all geographical regions of WA.

Introduction and Summary

On 24 November 2003, the Commonwealth Treasurer announced the Commonwealth Government's decision to review aspects of the income tax self-assessment system. In announcing the review, it was noted that the review would "identify whether there are refinements to the present arrangements that would reduce the level of uncertainty for taxpayers, reduce compliance costs and enhance the timeliness of Australian Taxation Office (ATO) audits and amendments, while preserving the capacity of the ATO to collect legitimate income tax liabilities."

In addressing these issues, the review focuses on:

- protection for taxpayers from unreasonable delays in enforcing the tax law;
- the statutory timeframes for amending assessments;
- length of tax audits;
- aspects of the operation of the general interest charge;
- the level of reliance taxpayers should be able to place on taxation rulings and other forms of ATO advice; and
- the circumstances in which the ATO should undertake earlier examination of tax returns.

As the title of the review suggests, this review looks at "aspects" of the income tax self assessment system. CCI doubts that the review will achieve its stated objectives without a more fundamental review of the system itself and the income tax laws on which it is based.

CCI considers that a review of the self-assessment system needs to resolve two key issues:

- the uncertainty for taxpayers, which is a result of the system itself; and
- the income tax laws, which have become increasingly complicated and difficult to understand, significantly increasing taxpayer compliance costs.

A measured response could involve the return to a modified pre-issue assessment regime, which would require the ATO to be more proactive in interpreting tax law in order to reduce uncertainty for taxpayers. Such a regime could also help to simplify tax laws, which have in many ways been complicated as a result of the self-assessment system.

In addition, it is clear that further work needs to be undertaken to reduce the volume and complexity of tax legislation in order to reduce uncertainty for taxpayers and the associated burden of compliance and administration. In the absence of a process whereby the policies behind the income tax laws can again be reviewed (following the Government's opposition to some of the key recommendations of the Ralph Review of Business Taxation), there remains a clear need to look at ways in which the income tax laws themselves (not the policies behind the laws) can be simplified.

This would best be achieved through the re-establishment of the Tax Law Implementation Project – an initiative of the previous Government which was effectively shelved in 1999 so that the resources could be devoted to the GST and business tax reform process.

Problems with the Current System

The introduction of self-assessment in 1986-87 relieved the ATO of the responsibility to examine returns lodged by taxpayers in the process of assessment. Taxpayers are now required to lodge their tax return, with any claims made by a taxpayer generally accepted by the ATO, usually without adjustment, before issuing an assessment notice. However, even though the ATO may initially accept the tax return, the return may still be subject to further review.

As this system requires taxpayers to have a good understanding of the tax law in order to fulfil their taxation obligations, the ATO's role has shifted to providing advisory services such as private rulings to improve taxpayer knowledge of the application of the tax law to individual circumstances. In addition, resources devoted to post-assessment checking has increased through audit activity.

Under the system of self-assessment, the ATO has been able to move from the position of having to understand and be able to apply the income tax law on a consistent basis, to instead passing on that responsibility to taxpayers and their advisers. As highlighted by Michael Inglis:

“...the ATO was able to move from what had become the uncomfortable position of having itself to understand, and be capable of genuinely applying on a consistent Australia-wide basis, the income tax law, to the more comfortable position of armchair critic. The full burden of getting and staying up to speed on, and contending day by day with, the newly expanded and more complicated income tax laws (not to mention existing ones) was thus taken off the shoulders of the ATO and put onto the shoulders of taxpayers and their advisers.”¹

This is in stark contrast to the previous system of full assessment, where ATO officers were able to gain ongoing first-hand experience and knowledge of whether the income tax law was workable or not when issuing assessments.

The system of self-assessment has been made all the more difficult for taxpayers given that the tax laws have become increasingly complex and lengthy, with over 8,500 pages of legislation spread over three different Acts (*Income Tax Assessment Act 1936*, *Income Tax*

¹ Inglis, M, “Is Self Assessment Working?”, Australian Tax Review, June 2002.

*Assessment Act 1997, Schedules to the Taxation Administration Act 1953) and many more thousands of pages in general public rulings*².

In part, the increased amount of detailed income tax legislation has been an attempt to clarify all possible events or circumstances that can arise to increase certainty for taxpayers. However, it has had the opposite effect. The average taxpayer now finds it more difficult to understand and comply with the tax laws.

Such is the complexity of the system, the ATO has reported that around 75 per cent of all tax returns and activity statements are lodged with either complete or partial involvement of a tax professional. This is the highest of any country in the world.

The pressures on taxpayers and tax advisers to fulfil their tax obligations are compounded due to the uncertainty as to whether they will be audited for incorrectly completing their tax returns (potentially requiring payment of additional tax plus interest), or, worse still, avoiding tax (which can attract large penalties). This level of uncertainty is an unwelcome aspect of the system of self-assessment.

Despite the ATO's best efforts and intentions in providing rulings when requested, the practical issues for taxpayers and tax agents means that, for many reasons, the need for an ATO ruling may not be identified or, if it is considered, it may not be sought for any number of valid pragmatic reasons (not to do with minimising tax). By doing this, however, the onus on the taxpayer has now meant the ATO does not have to take a position on a tax matter until after the event.

The shift in obligations and responsibilities away from the ATO, combined with the threat of penalties at audit if a taxpayer gets it wrong, is seen as the key concern with self-assessment.

Options for Reform

The system of self-assessment is in need of reform. It has brought about a clear shift in accountability and responsibility towards the taxpayer which in some cases, the taxpayer cannot reasonably comply with. The increasingly complex income tax laws and the threat of audit if taxpayers incorrectly complete their tax affairs, creating an uncertain environment.

While the ATO's efforts to provide taxpayers with information in order to explain complicated tax law and its application are to be commended, this has not improved the system. If anything, the flood of additional information has complicated matters further.

As a result, CCI believes that a review of the self-assessment system needs to resolve two key issues:

- the uncertainty for taxpayers, which is a result of the system itself; and
- the income tax laws, which have become increasingly complicated and difficult to understand for taxpayers and tax advisers.

Addressing these fundamental issues would also help address the issues outlined in the terms of reference to the review.

Modifying the System

In relation to the system of self-assessment, a measured response could be a move to a modified pre-issue assessment regime, possibly involving a pre-assessment issue computer

² Inglis, M, "Is Self Assessment Working?", Australian Tax Review, June 2002.

check of returns using the same (or similar) parameters now used to identify possible audit cases.

In doing this, ATO assessors could then decide whether it should amend the returns (for simple errors of calculation) or seek further information from the taxpayer. If further information is necessary, then the taxpayers identified during this process would then have to substantiate or explain any issues raised before an assessment is issued.

This would allow the ATO to be more proactive in interpreting tax law and resolving issues at an earlier stage, rather than after assessments have been issued.

This should not reduce the obligations on taxpayers and agents to correctly identify and classify tax issues in their tax returns. Nor would it mean that the ATO could not audit a taxpayer's affairs after an assessment had been issued (just as they did prior to the introduction of self-assessment).

Such a process would give the most taxpayers and agents some comfort that returns had been assessed and relevant issues raised as appropriate before any assessment issued.

While this would increase the time with which the ATO would take to issue assessments, this would be a small price to pay if there was a greater degree of certainty that future audits would not give rise to any significant issues.

A modified pre-issue assessment regime could also help simplify the income tax laws, which have in many cases evolved as piecemeal responses to problems identified under the system of self-assessment.

Simplifying Income Tax Law

Few taxpayers or tax professionals would disagree with the proposition that the income tax laws have become too complex and difficult to understand.

Under the previous system, the ATO issued income tax assessments determined by ATO assessors on the basis of their own understanding and application of the income tax law to various facts and circumstances. In doing so, the ATO gained on-going first hand experience and knowledge as to whether the income tax law was workable or not.

The removal of this vital feedback element from the Australian tax system has been a key factor behind the development of complex and detailed income tax laws that are often practically unworkable.

In order to ensure a satisfactory system of tax administration, the law should be clear and taxpayers should know, without difficulty, when tax will be payable and when it will not. The system should also be stable and not subject to constant change. The cost and inconvenience to the taxpayer of complying with the law should also be kept to a minimum.

The income tax laws fall far short of achieving a satisfactory system of tax administration. As a result, reform is necessary in order to make the income tax law accessible and clear, and easier to apply and less burdensome to comply with than the present law.

This is best achieved through a fundamental review of the income tax laws, including the policies behind the laws – a process that was undertaken as part of the Ralph Review of Business Taxation. Indeed, the Ralph Review proposed a number of reforms not supported by the Government that would have greatly simplified the income tax laws, particularly the

proposed Tax Value Method (TVM). The Board of Taxation noted in 2002 that tax law based on the TVM could reduce the current law by around 40 per cent.³

In the absence of policy-driven reforms to the income tax system, such as the proposed TVM, there remains a clear need to simplify the existing tax laws within the current policy boundaries.

It is noted that the previous Government initiated a process aimed at simplifying the income tax law when it established the Tax Law Improvement Project in 1993. The results of this project was the *Income Tax Assessment Act 1997* which contained many key sections of the *Income Tax Assessment Act 1936* rewritten in plain English using shorter and clearer sentences and improved presentation through increased use of maps, graphics, tables and examples.

However, the current Government effectively shelved this program in 1999, with the resources devoted to the GST and business taxation reform process. While the subsequent legislation giving effect to the business tax reforms provided a more integrated design processes and a more principle-based legislative framework, a more fundamental look at reducing the complexity of the current income tax laws was not addressed.

Many tax professionals and advisers felt that the Tax Law Implementation Project was making real progress in improving the style of the drafting of tax legislation and in improving comprehension.

With the project incomplete, the result is that the old Act is still in operation to the extent that the new Act is still not yet a completed revision of the old Act. Therefore, Australia now has two systems of income tax law that can be operating in tandem or even in conflict with one another where neither Act deals exclusively with the relevant tax problem.

It is therefore important that a process that began with the Tax Law Implementation Project be restarted to finish the rewrite of the 1936 Act.

³ Board of Taxation Press Release, “Current Income Tax Laws Unsustainable – Tax Board Chairman Tells Convention”, 15 March 2002.