



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS LEGISLATION COMMITTEE

Reference: A New Tax System (Tax Administration) Bill (No. 2) 2000

MONDAY, 19 JUNE 2000

CANBERRA

BY AUTHORITY OF THE SENATE

WITNESSES

**KOVIC, Mr Stefan, Executive Officer, Law Design and Development, Small Business,
Australian Taxation Office 1**

**SMITH, Mr Michael, Assistant Commissioner, Small Business, Australian Taxation
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SENATE
ECONOMICS LEGISLATION COMMITTEE
MONDAY, 19 JUNE 2000 **Monday, 19 June 2000**

Members: Senator Gibson (*Chair*) Senator Murphy (*Deputy Chair*), Senators George Campbell, Chapman, Murray and Watson

Participating members: Senators Abetz, Boswell, Brown, Brownhill, Calvert, Conroy, Cook, Coonan, Crane, Eggleston, Faulkner, Ferguson, Ferris, Harradine, Knowles, Lightfoot, Lundy, Mason, McGauran, Parer, Payne, Quirke, Ridgeway, Schacht, Sherry, Tchen and Tierney

Senators in attendance: Senators George Campbell, Gibson and Sherry

Terms of reference for the inquiry:

A New Tax System (Tax Administration) Bill (No. 2) 2000.

Committee met at 8.04 p.m.

CHAIR—I call the committee to order. The committee is now considering A New Tax System (Tax Administration) Bill (No. 2) 2000. The committee's scheduled reporting date is Thursday, 22 June. This is a public hearing and all members of the public are welcome to attend.

Before we commence taking evidence, I wish to state for the record that all witnesses appearing before the committee are protected by parliamentary privilege with respect to evidence provided. Parliamentary privilege refers to the special rights and immunities attached to the parliament or its members and others necessary for the discharge of the parliamentary function without obstruction and fear of prosecution. Any act by any person which operates to the disadvantage of a witness, on account of evidence given by him or her before the Senate or any of its committees, is treated as a breach of privilege.

Before we start this part of the program, can I remind committee members that under the parliamentary privilege resolutions agreed to by the Senate, officers of a department of the Commonwealth or of a state shall not be asked to give opinions on matters of policy. Officers shall also be given reasonable opportunity to refer questions asked of the officer to superior officers or to a minister.

KOVIC, Mr Stefan, Executive Officer, Law Design and Development, Small Business, Australian Taxation Office

SMITH, Mr Michael, Assistant Commissioner, Small Business, Australian Taxation Office

CHAIR—Do you wish to make an opening statement on this particular bill?

Mr Smith—It might help to set the context, I suppose.

CHAIR—Thank you.

Mr Smith—Since the bill was introduced on 11 May, there have been a number of press articles about it. For example, 'New bill cuts tax advisers out of the loop'. There is a

submission from Robert Warnock to the committee about his concerns in relation to the bill. When those concerns were raised the government asked us to go out and consult with people who felt that they were adversely affected by what the bill was doing. That has been done and the government intends, when the bill is debated, to introduce those amendments. We actually have letters from various people mentioned in these articles which say, basically, that they are comfortable with the nature of those proposed amendments.

In the overall context, this part of the bill—that is, the one dealing with tax agents' services which seems to have created the concern—is simply trying to restate what the current income tax and FBT laws contain in relation to who can and who cannot provide particular tax agents' services. As well as that, it actually creates the opportunity for people other than registered tax agents to prepare what we know as the business activity statements—if you like, to spread the base for the numbers of people who can prepare those in order to meet the demand that we have been reading about in relation to work and the new tax system.

CHAIR—Thank you very much. Any questions?

Senator GEORGE CAMPBELL—This bill actually consolidates a number of penalties in the penalties regime for the tax system. Does the number of penalties actually increase or decrease as a result of this bill?

Mr Kovic—The number of penalties in the law increases but the type of tenant penalties do not change. The bill consolidates the current penalty provisions in all the taxation laws and puts them into the Tax Administration Act. So it compresses basically about 180 pages of penalties into about 80 pages. But there is very little change to the type of penalties that are imposed under the laws. They are essentially the same. For example, with the income tax model where a person has a tax shortfall, that becomes the same model that applies to all taxes, including GST.

Senator GEORGE CAMPBELL—In relation to this new range of penalties, have the penalties increased or decreased in terms of monetary value?

Mr Kovic—Apart from income tax, they represent a decrease because at present where there is a tax shortfall the penalty is 200 per cent of the tax that has not been paid. The income tax model, the maximum penalty that can be payable there is 90 per cent.

CHAIR—So the 90 per cent applies?

Mr Kovic—Well, no. It depends on the behaviour of the taxpayer. It is a range of penalties. In most cases the penalty is 25 per cent of the shortfall amount. That is where a person fails to exercise reasonable care. If they are reckless it is 50 per cent, and if there is intentional disregard of the law it is 75 per cent. But in all those cases where there are aggravating circumstances there is a 20 per cent loading, and that brings the 75 per cent up to 95 per cent.

Senator GEORGE CAMPBELL—Is that different from the current regime of penalties? Is this going to involve the Taxation Office in making value judgments about whether people have done this through accident or design; whether they have been only nominally complicit or whatever?

Mr Kovic—No, it is the model which currently applies to all income tax shortfalls. For FBT, sales tax and GST, the 200 per cent model is there, but it has always been the ATO's practice to adopt the income tax model in exercising remission provisions to reduce the penalty to a lower level.

Senator GEORGE CAMPBELL—Can you explain to us what the penalties are that relate specifically to the business activity statement?

Mr Kovic—The business activity statement highlighted the fact that there were a number of different penalties applying for the different taxes. For instance, if a person understated their withholding amounts, there was a penalty for failing to notify of a flat eight per cent. But if a person understated a GST amount, it was a 200 per cent penalty. This bill means that no matter what type of revenue is understated, taxpayers will face the same penalty, based on their behaviour. So, if a person does not exercise reasonable care, the law imposes a 25 per cent penalty on the tax shortfall.

Senator SHERRY—Are you able to give us a comparative schedule list?

Mr Kovic—I cannot provide it to you now, but I could let you have one.

Senator SHERRY—Before we debate this in the Senate?

Mr Kovic—Certainly.

Senator GEORGE CAMPBELL—Are the penalties only in relation to the shortfall?

Mr Kovic—No. There are three basic categories of penalties. One is the tax shortfall, and that also includes scheme cases. The next category is late lodgment penalties, and under the current law there are myriad penalties that apply to late lodgments of documents. The third category is for miscellaneous penalties, where taxpayers fail to do certain things, such as not send an amount in electronically where they are required to pay electronically, failure to issue a tax invoice where they are required to issue a tax invoice and so on. The late lodgment penalty is a generic penalty that will now apply to all forms that are required to be furnished to the Commissioner. It imposes a penalty of one penalty unit per 28-day period up to a maximum of five penalty units. So \$550 is the maximum penalty that can apply for late lodgment. If a taxpayer is a medium-sized entity, there is a multiplier of two applying to that. So it would actually go up to a maximum of \$1,100. A medium entity is a taxpayer whose turnover is between \$1 million and \$20 million. For large entities—those who have a turnover greater than \$20 million—the multiplier is five.

There are increases in penalties in that particular provision for some taxes, but a reduction for others. With the late lodgment of returns for taxpayers on a self-assessment system—that is companies and superannuation funds—they currently pay a penalty of \$10 a week up to a maximum of \$200. That penalty has been seen to be inadequate for a number of years. It is almost an administrative burden for the ATO to have to administer and it raises a lot of complaints. So with this penalties model, we actually went out to the various professional bodies and floated the proposals to them. They have all agreed that the penalties are not unreasonable.

Senator GEORGE CAMPBELL—So in fact there are increases in the penalties?

Mr Kovic—Well, for some there are—for instance, that late lodgment penalty that currently applies for income tax returns. Whereas for an individual who is late in lodging, the penalties that apply at present depend on the amount of tax that is outstanding. If a person has a large amount of tax outstanding, the penalty that applies there is a general interest charge for the number of days that are outstanding. For a return that is two years late, there could be thousands of dollars in penalties applied for an individual. We have had situations where individuals have faced \$10,000 or \$20,000 in late lodgment penalties outstanding. In those cases that will now come back to being a maximum of \$550. I stress that those are just the upper limits and all these penalties have to be viewed in the light of the Commissioner's remissions guidelines and policies that are currently being developed.

Senator SHERRY—You mentioned a reduction from 180 pages to 80. Is that because you have taken the penalty provisions from a number of acts, put them in and effectively cut down the level of duplication?

Mr Kovic—Yes, it is the reduction in the duplication, and there is also some shortening in the wording that is currently in the income tax law that we have used as the model for tax shortfalls. It has been written in a more plain English style, so, hopefully, it is easier to understand.

Senator GEORGE CAMPBELL—What type of taxpayers are most prone to the imposition of penalties? Is it individuals or companies?

Mr Kovic—All taxpayers. The way the penalties work, as soon as someone has not complied with the law, the maximum penalty applies. It comes down to the Commissioner's remission policy as to who eventually ends up with a penalty. The Commissioner has said that in exercising those remission policies, tax officers have to have regard for the compliance model from now on. That means that if someone is making a genuine attempt to comply with the law, the penalties would be remitted in full.

Senator GEORGE CAMPBELL—I understand that. What I was asking was: what type of taxpayer is most prone to the imposition of penalties? Is it the individual taxpayer, or is it companies?

Mr Kovic—I do not have any figures on that break up, but it depends on whatever compliance action we are taking. If we are targeting companies in a particular area and we find that there has been underpayment of tax, penalties will be applied. If we undertake a compliance action in respect of work-related expenses—which can involve thousands of taxpayers—if there are understatements there, then thousands of taxpayers will face a penalty. What is important in the new tax system is that the Commissioner can say, 'If someone has a good compliance history and they have tried to do the right thing, we have to remit the penalty in full.'

Senator SHERRY—Do you keep a central register of penalties that are applied to people—or, for that matter, to any entity—in each financial year?

Mr Kovic—My understanding is that the system only records the amount of penalties that are imposed in total, so we can get a break up of the total tax shortfall penalties, the total late payment penalties, the total of late lodgment penalties and so on. Separate areas in the office would probably have statistics relevant to their own area.

Senator SHERRY—Okay. But not in respect to, say, trusts, companies, individuals or individuals by income level? You do not keep that data?

Mr Kovic—I am not aware whether we have that data. We might. I could take that question on notice and get back to you.

Senator GEORGE CAMPBELL—So essentially it depends on the campaigns you happen to be running at any given point in time?

Mr Kovic—Yes. It is all about trying to target those areas where we think non-compliance is the greatest. If we are doing that job properly, there should be penalties imposed in most of those cases.

Senator GEORGE CAMPBELL—What did the Commissioner mean when he said recently that the ATO would exercise a degree of leniency in regard to the application of penalties under the new system?

Mr Kovic—It is a recognition that this is a new tax system and taxpayers have to understand what the new laws are all about. It is a huge change and we cannot expect taxpayers to know everything right from the start. Our role is to be out there to educate and help taxpayers to understand their obligations. I think he said that sometime after 1 April he might start undertaking some compliance action to see whether people are complying and whether they do understand the system. If a taxpayer had not received any advice or help from the ATO and was making a genuine attempt to try to get it right, the Commissioner is saying that that person should not be penalised. But if someone is deliberately trying to flout the law, or is sitting on their hands and doing nothing about it, then a higher penalty will apply.

Senator GEORGE CAMPBELL—So are you saying that that provision would apply across the board, or would it depend on the particular taxpayers who are involved? Would you take a different view of Joe Bloggs, who runs the corner store, as opposed to, say, BHP?

Mr Kovic—Yes, definitely. The larger corporates that have in-house accounting and taxation advisers are in a position to be able to better comply with the law. But at the same time we have to appreciate that they are like any large organisation—they are facing a huge change which does involve a lot of work for them. We have to be mindful of that. The little family corner store does not have the same resources available, and we are there to try to help them understand their obligations, not put a penalty on them.

Senator GEORGE CAMPBELL—In the explanatory memorandum, which refers to the concept of a ‘reasonably arguable position’ in regard to the tax law, can you explain what that means and what type of taxpayers would make use of it?

Mr Kovic—The ‘reasonably arguable position’ is a test that applies only to larger taxpayers. It is a test that only applies only to income tax shortfalls; it does not apply to any of the other taxes. What it requires is where there are large amounts involved, taxpayers must have a reasonable position on a question of law—that is, the position they take has to be as likely or not to be correct. The threshold is the greater of \$10,000 or one per cent of tax payable, so it is only the larger mediums and the large corporates that ever fall into a position where they have to meet those tests. There would be very few individual taxpayers who would be involved—

Senator GEORGE CAMPBELL—You said it only applies to income tax?

Mr Kovic—Yes. It is not a test under the GST law or the FBT law. It is something that is unique to income tax.

Senator SHERRY—I may be incorrect here, but you seem to be arguing that this is actually an increase in penalty, or the application of penalty.

Mr Kovic—No, that penalty on ‘reasonably arguable position’ is something that is in the current law. All we are doing is transferring that into the new provisions out of the Income Tax Assessment Act into the new tax administration act.

Senator SHERRY—I noticed a report in the *Financial Review* last week relating to income tax refunds. It was alleging that there are delays in the processing of income tax refunds and there will be delays in the coming financial year. It claimed that this was because of the new tax system, particularly the GST. Is that correct?

Mr Kovic—I am sorry, I could not answer that question.

Senator SHERRY—The argument was that the average time for processing a refund was two weeks, and that this was blowing out because of additional workload pressures within the ATO.

Mr Kovic—Another reason why there could be a delay is that we are right at the very end of the lodgment cycle for tax agents, so they are trying to lodge the bulk of their returns at present.

Senator SHERRY—But do you know specifically whether the time period has blown out?

Mr Kovic—I have no idea whether there has been a delay or whether it is just a report in the press.

Mr Smith—Would you like us to cover that, Senator?

Senator SHERRY—Would you take it on notice, please?

Mr Smith—Yes, certainly. Do you have that article from the *Financial Review* there?

Senator SHERRY—No, I am sorry, I do not. I am sure someone in your office has sighted it.

Mr Smith—Probably not in our area!

Senator GEORGE CAMPBELL—On the business activity statement and the decision to allow the broadening of the category of people who can prepare the statement for lodgment, who does that now encompass, other than registered tax agents?

Mr Kovic—It encompasses any member of a recognised professional association.

Senator GEORGE CAMPBELL—What is a recognised professional association?

Mr Kovic—That is defined in the laws; basically it is any body that represents—probably accountants and lawyers.

Senator SHERRY—No wider? What about financial advisers, for example, many of whom do not have professional qualifications?

Mr Kovic—No, it does not cover financial advisers unless they are particular bodies which satisfy the requirements in the definition.

Senator SHERRY—What about a lawyer or an accountant?

Mr Kovic—Well, they have to have qualifications in law or accounting. It also picks up book-keepers working under the direction of registered tax agents. It picks up payroll bureaux in respect of PAYG withholding work..

Senator SHERRY—Is that an expansion or a reduction in persons who are eligible to act in this area?

Mr Kovic—It is an expansion. Currently the only people who can receive a fee for transacting business on behalf of a taxpayer in income tax matters are either a registered tax agent or solicitors and barristers who can undertake certain work. So by widening it to bookkeepers and also members of recognised professional associations that are not registered tax agents, it is considerably expanded.

Senator SHERRY—Do you see any risks involved for taxpayers? ‘Bookkeepers’ is a fairly nebulous term.

Mr Kovic—That is why they have to work under the direction of a registered tax agent.

Senator SHERRY—Where does the legal liability fall if there are errors made or some sort of fraud is perpetrated?

Mr Kovic—The liability for any penalties always rests with the taxpayer—

Senator SHERRY—Yes, I understand that.

Mr Kovic—They are vicariously liable, but any legal liability would fall either on the bookkeeper or the registered tax agent. This is all part of a broader process that has been going on for the past few years involving a national review of standards of the tax profession. The various accounting and legal professional bodies and also some of the tax professional associations have been developing new standards for tax agents. One of the issues to be resolved there is the role of people such as financial advisers and superannuation consultants and where they fit into the scheme of things.

Senator SHERRY—They are not being incorporated, are they?

Mr Kovic—No, they are not being incorporated.

Senator SHERRY—I would have some concerns if they were.

Mr Kovic—No, they are not. But that is an issue to be resolved as part of this broader review. The government has flagged that they intend to introduce legislation later this year.

Senator SHERRY—Just on the question of bookkeepers: do you have any idea of the likely numbers of people who will be added to the system?

Mr Kovic—No, I cannot say with bookkeepers. But if you look at the members of recognised professional associations, I think that in CPA Australia and the Institute of Chartered Accountants only about one-fifth of their members are registered tax agents. So there is a considerable increase in the number of people who can undertake that work.

Senator SHERRY—Why is that?

Mr Kovic—Why is their membership structure that way?

Senator SHERRY—No, why is there a considerable increase in the number of people in that area, for example?

Mr Kovic—If there are, say, 5,000 registered tax agents that are members of the Institute of Chartered Accountants—I think that is just an approximate number—and there are 25,000 members of that body, then there is an additional 20,000 people who can undertake the BAS service work.

Senator SHERRY—They might be accountants who might have gained a paper qualification many years ago. Could they now enter without any check or restriction?

Mr Kovic—No, those professional bodies require their members who are going to undertake public practice to maintain their level of continuing professional education. Also, they have rules about professional indemnity insurance. If they are going into public practice, there are safeguards.

Senator GEORGE CAMPBELL—How do they test them?

Mr Kovic—My understanding is that they do not actually undertake any testing, but people are required to have certain qualifications before they can become members of those bodies. They also have student memberships. But both CPA Australia and the Institute of Chartered Accountants have professional years and a person would have to undertake either the professional year or the CPA program and pass that before they could become a public

practising accountant. Then there are ongoing requirements for continuing professional education. There are requirements that they undertake a certain number of hours each year.

Senator SHERRY—You do not have any idea of the number of ‘bookkeepers’?

Mr Kovic—No, I am sorry. I do not have any idea.

Senator SHERRY—I am just worried about this: the professional organisation is not checking on their qualifications. It is an indirect check through the individual member of the association. Is that the way it would be done?

Mr Kovic—They have rules about the supervision and control that their members are required to have over their practices. There are also audits undertaken of their practices to see whether or not the work of people working either under contract or as employees is up to standard.

Mr Smith—It is a little bit tighter than that. It has to be under the direction of a registered tax agent, not under the direction of a member of that professional body.

Senator SHERRY—But there must be an impact on, for example, indemnity insurance. If you were providing indemnity insurance to a registered tax agent, and the tax agent was then delegating a greater amount of work in, presumably, a more complex area, would bookkeepers be covered by that insurance?

Mr Kovic—I am sorry, I could not answer that because I am not aware of the nature of the professional indemnity insurance that applies to bookkeepers. However, one of the features of the national review of standards of the tax profession is a new code of practice that will apply to all registered tax agents. There are actually requirements in the code of practice relating to the supervision of contractors and employees. That is an additional control that there will be, once these other proposals are put forward.

Senator SHERRY—I just worry that a consumer who would go to have a tax return done might find that the bookkeeper interviews them and obtains appropriate details. The consumer may not be aware that that person is a bookkeeper as distinct from an accountant.

Mr Kovic—The bookkeeper is not allowed to do any income tax work. They are only able to do the BAS preparation and lodgment work, which is basically seen as more of an accounting or bookkeeping function as opposed to a role involving interpretation of the law. It is more or less a task of pulling in the turnover details of a particular taxpayer, having it processed through the accounting software, and coming up with some figures that can be translated into the business activity statement. It is not a matter of making judgments about whether or not something is deductible or assessable or taxable.

Senator SHERRY—It just seems to me that in practice it could become a fairly thin line to define at times.

Mr Kovic—The same thing could be said at present of a member of staff. How closely are staff supervised? What is the actual quality of work that is being undertaken by an accountant or a registered tax agent?

Senator GEORGE CAMPBELL—And you say that is relaxation of the rules and nothing to do with the new, simplified tax system that is going to be easier for us all to understand?

Mr Kovic—Well, the business activity statement is more simple than the income tax system.

Senator SHERRY—If it simpler, why do we need more people to help with the preparation of the work required?

Mr Smith—Well, there are more of them, I suppose—more business activity statements needing to be prepared. You are quadrupling the frequency—you are doing one a quarter, rather than one income tax return a year; or one a month in the case of some medium people who might elect to pay monthly.

Senator SHERRY—So if you define simplification in terms of quantum of work, it is not simplification.

Mr Smith—It is paying as you go. It is all about—

Senator SHERRY—We know they are going to pay as they go!

Mr Smith—That is what it is each quarter—it is a quantifying of what has gone on in that quarter, and then ascertaining what the liabilities are, based on that quarter's activities.

Senator GEORGE CAMPBELL—Well if it is such a simple system, you should be able to do it yourself!

Mr Smith—Some people might.

Senator GEORGE CAMPBELL—The PAYG system: could you explain to us how the withholding tax will apply in respect to labour hire firms?

Mr Smith—That has nothing to do with this bill.

Senator GEORGE CAMPBELL—The PAYG system?

Mr Smith—We talked earlier about payroll bureaux being able to contribute to the preparation of a BAS. That is only in relation to that part of the BAS that is covered by the PAYG withholding system. I am just looking at page 27 of the bill, where it talks about 'where a BAS service is under Part 2-5 of Schedule 1...' That is, if you like, the replacement of the current PAYE system. As part of that replacement, in one of the early bills that has gone through the parliament, it is breaking up what is currently covered by the PAYE system. At the moment, under the PAYE system, there is this concept of salary or wages, which covers a myriad of payments to lots of different individuals, and some of those individuals may be people who get payments under contracts. They are not employees, but they are getting payments under contracts, principally for their labour.

Under the new PAYG system, those payments by a labour hire firm to an individual, principally for that individual's labour, is one withholding event, so that when those payments are made, there is a withholding obligation on that labour hire firm and the amounts withheld would form part of that BAS statement.

Senator GEORGE CAMPBELL—Why are those changes required?

Mr Smith—They are not really changes in that at the moment, if I were a labour hire firm and I was paying an individual principally for their labour, the current PAYE system would cover those payments. Under the new tax system, PAYE has been subsumed, if you like, into the new PAYG withholding system. So these changes are required as part of the government's new tax system.

Senator SHERRY—Do you think that improves the tracking?

Mr Smith—In relation to employers paying salary or wages or labour hire firms paying those payments, there is probably not much difference. The big advantage, as far as componentising the current PAYE system is concerned, is, on the face of it, the fact that these

recipients from labour hire firms are not called employees, which they are called under the current law. The current law has this concept of an employee as anyone who receives salary or wages, and that concept covers company directors, some people receiving payments from labour hire firms and what have you. So the PAYG withholding system actually takes each of those payments and gives them a separate event. It tries to introduce certainty into the system. As far as the overall mechanics and coverage go, there is probably little difference.

Senator SHERRY—Why make the change then?

Mr Smith—It is part of the new tax system. I cannot add any more than that.

Senator SHERRY—Is it simpler? Does it collect more revenue?

Mr Smith—From a PAYG withholding perspective, the revenue should basically be the same. When you go into the PAYG instalment system, there is certainly a bringing forward of revenue. As we know, under the current company tax system, companies are paying tax now in respect of income that they earned sometimes 18 months earlier.

Senator SHERRY—And the ATO will be tracking the revenue collected?

Mr Smith—It certainly would be.

Senator SHERRY—Will you be able to provide us, at some point in time, with some historical data as to what is happening to revenue collection in this area?

Mr Smith—In relation to PAYG instalments and PAYG withholding?

Senator SHERRY—Yes.

Mr Smith—I cannot see why not, Senator.

CHAIR—Are there any further questions? As there do not appear to be, I would like to thank Mr Smith and Mr Kovic for appearing before the committee tonight. That completes our hearing on this particular bill. The committee stands adjourned.

Committee adjourned at 8.41 p.m.