# 7

# Pay as you go and common standards of practice

## Pay as you go – introduction

7.1 The previous Government introduced the pay as you go system (PAYG) in 2000 as part of the 'A New Tax System' reforms. It introduced two main approaches to tax payments, PAYG withholding (generally employees) and PAYG instalments (generally recipients of business and investment income). PAYG replaced nine other payment systems. Treasury explained the benefits of PAYG over previous arrangements:

> These former collection systems duplicated obligations or were inefficient and outdated in their own right. In particular, the former PAYE [pay as you earn] system relied on outmoded ideas to define obligations and had not kept pace with labour market trends. Instead, the PAYG withholding system specifies the types of payments from which amounts are required to be withheld. It also caters more effectively for new work practices through the introduction of new rules to cover payments under labour hire arrangements (which can be extended to new work arrangements as they emerge)…[1]

7.2 PAYE was introduced for the 1944-45 income year.[2] By requiring taxpayers to contribute to their tax obligations as they earn the relevant income, both PAYG and PAYE decreased the risk of taxpayers defaulting

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1 Treasury, sub 51, p 12.

2 Joint Committee of Public Accounts, *An Assessment of Tax: A Report on an Inquiry into the Australian Taxation Office* (1993) Report 326, p 206.

on these debts. In its submission, Treasury gave an overview of the advantages of PAYG:

> The PAYG system ensures that most taxpayers pay income tax … 'as they go' during the income year. Although the amounts are paid before an annual assessment is made, they are paid after the related income has been derived. The PAYG system provides a more even stream of revenue to the Government to fund services throughout the year, as well as smoothing business cash flow. It also avoids taxpayers accruing large tax liabilities on assessment which they may have difficulty paying as a lump sum.[3]

7.3 PAYG and its predecessors have had other benefits. For example, requiring employers to pay tax on behalf of their employees is more efficient than requiring each employee to do this themselves.[4]

7.4 Submissions that discussed the PAYG system generally focussed on the over collection of tax. This is the amount of tax collected under PAYG but returned to taxpayers after the reconciliation process that occurs when taxpayers lodge their returns. Although fundamental reform is possible in the long term, this chapter concludes that over collection is a necessary aspect of the tax system as it currently stands.

## Legal framework

### Pay as you go withholding

7.5 The *Taxation Administration Act 1953* gives the legal framework for PAYG. Section 12-35 requires an entity (employer) to withhold an amount from salaries, wages and similar payments paid to an employee. Sections 12-80 to 12-90 make the same requirement in relation to superannuation and unused leave paid to an individual.[5]

7.6 There are three main legal questions in this requirement. The first is the definition of an 'employee.' The Australian Taxation Office (ATO) has addressed this in Taxation Ruling TR 2005/16. The Ruling discusses the difference between an employee and a contractor. Relevant factors include:

3 Id, p 12.

4 Id, p 13.

5 Discussion on PAYG withholding and instalments derived from Cooper G et al, *Cooper, Krever & Vann's Income Taxation, Commentary and Materials* (2005) Thomson, pp 867-75.

- the way in which the entity exercises control over the individual's work
- the extent to which payment depends on results
- the extent of the individual's power to delegate
- the amount of risk borne by the individual
- to what extent the individual provides their own tools and equipment and pays business expenses.[6]

7.7 The second issue is the type of payments from which an employer must withhold tax. The Act has a number of exemptions. These include exempt income and both cash and non-cash fringe benefits.

7.8 The third question is how much tax employers should withhold. Sections 15-10 and 15-25 in Schedule 1 to the *Taxation Administration Act 1953* give the Commissioner the power to draw up withholding schedules. Section 15-30 requires the Commissioner to have regard to the legislated tax rates and family tax benefit in drafting the schedules. In practice, the ATO sends the schedules to employers, who apply them. The ATO builds a 'very small' amount of over withholding into the schedules.[7]

7.9 Section 16-25 states that if an employer does not withhold an amount as the Act requires, or does not pass on this amount to the ATO, they are liable to a penalty of 10 penalty units ($1,100).[8] Large employers must pay withholding amounts on Mondays and Thursdays, generally within a week and a half of the payment to the employee. Small employers pay the least often. They are liable for a single amount quarterly.[9]

7.10 Employees can vary the rate at which their employer withholds tax. Section 15-15 allows the Commissioner to vary the withholding rate for an employee or class of employees. The ATO has created an application form for this process. Employees can vary their withholding rates upwards or downwards. The ATO reported that common reasons for variation are:

- high levels of deductible expenditure to be claimed against an allowance which would normally be taxed
- losses from rental properties or other ventures…

6 ATO, 'Income tax: Pay As You Go - withholding from payments to employees,' TR 2005/15, viewed on 18 June 2007 at http://law.ato.gov.au/atolaw/view.htm?docid=TXR/TR200516/NAT/ATO/00001.

7 ATO, sub 50.3, p 18.

8 Section 4AA of the *Crimes Act 1914* sets the amount of a penalty unit at $110.

9 Section 16-75 in Schedule 1 to the *Taxation Administration Act 1953*. Although the legislation refers to the size of the withholding amounts, rather than the number of employees, the two will usually be closely correlated.

- preference for [an] end of year refund.[10]

7.11 The ATO has systems to manage the risk that taxpayers may set low withholding levels as a means of avoiding or postponing tax. It does so by placing a number of requirements where applicants request a downward variation. In addition to providing all necessary information, applicants must:

- not have any outstanding tax returns
- not have had a debit assessment on their last tax return, if that return involved a PAYG withholding variation
- not have any outstanding tax debts to the Government or any other debt under an Act administered by the Commissioner.[11]

7.12 Where taxpayers' circumstances change following a variation, the ATO requires them to make a new application where they are likely to have a debit assessment of more than $500.[12]

## Pay as you go instalments

7.13 Section 45-15 in Schedule 1 to the *Taxation Administration Act 1953* states that taxpayers are liable to pay an instalment amount once they have received an instalment rate from the Commissioner. Further, once they receive this rate, section 45-20 requires them to report their income to the Commissioner. If taxpayers do not report their income, or under report their income, they are liable for a failure to lodge penalty (see chapter five).[13]

7.14 There are two key issues with PAYG instalments. The first is how many instalments the taxpayer is liable for. Section 45-50 implies that instalment taxpayers pay quarterly. This is the base position.

7.15 There are two variations to this base position. Section 45-140 allows taxpayers to instead pay annually if they meet a number of conditions. The main ones are that the taxpayer must not be registered for GST or need to register for GST, and must have a notional tax (tax on instalment income) of more than $8,000. Section 45-134 gives the second variation.

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10 ATO, sub 50, p 57.

11 ATO, 'PAYG withholding – varying your PAYG withholding, Downwards variations,' viewed on 27 June 2007 at http://www.ato.gov.au/businesses/content.asp?doc=/content/00096541.htm&page=3&H3=&pc=001/003/024/002/010&mnu=9898&mfp=001&st=&cy=1.

12 Ibid.

13 Section 45-25 in Schedule 1 to the *Taxation Administration Act 1953*.

Quarterly payers are allowed to pay twice a year if they are either farmers or 'special professionals,' namely sportspersons, authors, entertainers and inventors.

7.16 Section 45-80 states that late payments are subject to the general interest charge (GIC). Failure to lodge penalties also apply.

7.17 In 2006-07, there were 2.3 million PAYG instalment payers, of which 86% paid quarterly. The ATO issued 71,963 failure to lodge penalties to 48,803 taxpayers with a PAYG instalment obligation. Therefore, 2% of PAYG instalment payers incurred a failure to lodge penalty. The ATO applies a seven day period of grace to taxpayers so they do not incur the penalty if they are a few days late in lodging.[14]

7.18 The second main issue with PAYG instalments is the amount taxpayers pay at each instalment. The Act has several options. The first is to pay an amount based on last year's tax, adjusted for changes in GDP. This is the base position for the following quarterly payers:

- individuals
- companies and superannuation funds with less than $2 million income in the previous year
- entities that meet the criteria to be annual payers but have chosen not to do so.[15]

7.19 The legislation requires all other quarterly payers to calculate their payment on their income for the current period multiplied by an instalment rate that the Commissioner determines (the instalment income method). The instalment rate is an approximation of the taxpayer's income tax rate. Quarterly payers who meet the criteria to pay on the basis of a GDP adjusted amount can also request to use the instalment income method.[16]

7.20 Annual payers have two initial choices in determining their payment amounts. They may use the instalment income method or they may elect to base the amount on last year's tax, without adjusting for GDP.[17]

7.21 Similar to PAYG withholding, instalment taxpayers may vary their instalment amounts as long as they notify the Commissioner of this variation. However, taxpayers must exercise care in this because they are

14 ATO, sub 50.4, pp 4-5.

15 Deutsch R et al, *Australian Tax Handbook 2007* (2007) Thomson, pp 1753-54.

16 Id, p 1,747.

17 Id, p 1,759.

subject to GIC for any understatement of income each quarter greater than 85% of their actual income. Broadly, the GIC applies to the difference between the tax calculated on the 85% figure and the tax calculated on their predicted income. There is a 'fair and reasonable' test for remitting this GIC.[18]

7.22 By way of observation, the Committee received evidence from the Institute of Chartered Accountants in Australia that the PAYG legislation was substantially amended shortly after it came into effect. The Institute stated this made it 'extraordinarily complex legislation to read.'[19] The Committee concurs with this assessment. This piece of legislation lacks clarity and is difficult to read.

## Over collection of revenue

### The amounts involved

7.23 The Inspector-General of Taxation and CPA Australia expressed concern to the Committee about the level of tax that the ATO collects through PAYG but then later refunds to taxpayers.[20] For example, in 2006-07, the ATO collected $133.6 billion from all individuals and repaid $19.3 billion in refunds. The refund rate, as a percentage of tax initially paid, is 14.5%. The refund rate over the past few years has increased slightly. In 1995-96 it was 12.4%. In 2000-01 it was 12.5%.[21]

7.24 During the inquiry, the ATO provided a breakdown of these refunds for the Committee. It analysed individuals' tax returns lodged in 2004-05 for the 2003-04 tax year. This comprised 8.4 million tax returns. Refunds totalled $13.7 billion. In order, the main causes of refunds were:

- deductions and prior year losses of $5.2 billion
- withholding mismatches of $3.8 billion
- refundable tax offsets and credits of $2.7 billion (for example, the dividend imputation credit)

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18 Sections 45-115, 45-205, 45-210, Subdivision 45G in Schedule 1 to the *Taxation Administration Act 1953*. Arguably, varying the payment amounts constitutes a third method of calculating PAYG instalments.

19 Cantamessa S, transcript, 28 July 2006, p 68.

20 Inspector-General of Taxation, sub 48, p 15, CPA Australia, sub 36, p 16.

21 ATO, *Annual Report 2006-07*, p 21, ATO, *Annual Report 2004-05*, p 39.

- Family Tax Benefit of $1.1 billion
- tax offsets of $0.8 billion (for example, the termination payment rebate).[22]

7.25 The ATO made a distinction between two types of refunds. The first, or 'true' refunds, involved returning an amount that a taxpayer has already paid. The main types under this category included PAYG withholding and PAYG instalments. It totalled $9.9 billion for the period in the ATO's analysis.[23]

7.26 The remainder, or $3.8 billion, comprise Family Tax Benefit and tax offsets and credits. Taxpayers do not pay an initial amount to qualify for these, so they are not strictly refunds, although they are included in the definition.[24]

7.27 The ATO broke down these tax returns into three groups, according to taxpayers' level of withholding and instalments, calculated on gross income, and how this compared with their tax liability. The Committee has summarised the results of this research in table 7.1.

Table 7.1 Characteristics of tax refunds by level of withholding and instalments, 2003-04

| PAYG against actual gross income | Average gross and taxable incomes | Higher proportion of taxpayers | Main cause of refunds | Total refunds | Total tax-payers | Per capita refund |
|---|---|---|---|---|---|---|
| No PAYG | $14,398<br>$6,949 | Seniors and investors | Refundable tax offsets | $0.747 b | 0.77 m | $970 |
| Under paid | $56,034<br>$42,637 | Business and investors | Deductions and losses | $5.593 b | 3.02 m | $1,850 |
| Over paid | $31,533<br>$30,138 | Employees and youth | Withholding mismatches | $7.332 b | 4.56 m | $1,610 |

*Source* *ATO, sub 50.3, pp 19, 106-07.*

7.28 The group that does not withhold at all tends to have a higher representation of seniors and investors. In per capita terms, they have the lowest refunds. On average, they have the lowest income of the three groups. Even though they did not put any funds into PAYG, they received enough through refundable tax offsets and Family Tax Benefit to receive a tax refund.

7.29 The second group is those individual taxpayers whose level of withholding and instalments was less than that suggested by their gross income. They tended to be higher income earners and have a higher

22 ATO, sub 50.3, pp 18-19.

23 ATO, sub 50.3, p 18.

24 Ibid.

representation of business people. They mainly used deductions and prior year losses to reduce their taxable income so that, at the end of the financial year, they received a refund. Even though they under paid under the PAYG system, their significant levels of deductions meant that this group received the highest per capita refund of the three categories.

7.30 The final group is individual taxpayers whose level of withholding and instalments was higher than that indicated by their gross income. They tended to be middle income earners and had a higher representation of employees and young people. The ATO has advised the Committee that the PAYG withholding schedules have a small amount of over-withholding built into them, which would appear to explain why this group is mainly made up of employees. The main cause of refunds for this group is withholding mismatches that the withholding schedules do not cater for. For example, employees may only work for part of the year, they may have a second job taxed at the highest marginal rate, and some people receive promotions part of the way through the year.[25]

## Is over collection appropriate?

7.31 The Committee believes that, for the foreseeable future, a 'squaring up' tax process at the end of each financial year will be necessary to manage deductions and withholding mismatches.

7.32 In determining whether some over collection is appropriate, the Committee considered the example of Family Tax Benefits (FTB). The previous Government introduced the benefits on 1 July 2000 and the payment amount depends on the recipient's estimated income. As with all estimates, recipients occasionally make errors, which has led to a squaring up process (or reconciliation) at the end of the financial year for recipients who choose to receive it fortnightly. The Government obtains final income figures for these recipients through tax returns, which leads to a debt or credit. The ATO factors this debit or credit into taxpayers' final tax position.

7.33 This squaring up process had significant financial implications for the previous Government. For 2000-01, the Australian National Audit Office (ANAO) reported that 34% of recipients who received FTB fortnightly incurred a reconciliation debt. Out of total fortnightly FTB payments of $10.1 billion, the value of these debts was $584 million (5.8%). In July 2001,

25 ATO, sub 50.3, p 20.

the then Government announced a one-off waiver of all debts less than $1,000 per recipient. This reduced the reconciliation debt to $225 million.[26]

7.34 The squaring up process also had significant implications for families. Those that underestimated their income had significant debts that they found difficult to repay.[27]

7.35 The previous Government responded by introducing supplements for the FTB. In 2003-04, it introduced the FTB Part A supplement of $600 per child. In 2004-05, it introduced the FTB Part B supplement of $300 per family. The ANAO found that reconciliation debt for FTB became considerably less, largely due to the supplements:

> The ANAO found that the incidence of reconciliation debt had reduced from approximately 33%of the FTB population during the first two years of the program to under 10% of the FTB population in the most recent two years. The ANAO also found that the introduction of the FTB part A supplement in 2003-04 and the FTB Part B supplement in 2004-05 significantly reduced the number of FTB customers who incurred a reconciliation debt. Without the Part A supplement, 27% of customers would have incurred a reconciliation debt in 2003-04. However, with the supplement only 10% actually incurred a reconciliation debt for that FTB year. In 2004-05, 15% would have incurred a reconciliation debt but for the Part A and B supplements – only 5% actually incurred a reconciliation debt for that year.[28]

7.36 This example bears many similarities to PAYG. Taxpayers have an income estimate that the Government uses to determine their eligibility for a credit or debit. The Government uses the tax refund as a form of insurance for taxpayers. If their circumstances change and their tax liability increases, then the refund is some extra money that the taxpayer can draw on to either meet the liability of decrease the debt.

7.37 If the Government eliminates over collection in aggregate, there will be less taxpayers in credit and more taxpayers with a tax debt. The Committee's concern is that they will have similar difficulties in paying this debt as the recipients of FTB did in paying their reconciliation debt. To

26 ANAO, *Management of Family Tax Benefit Overpayments*, Audit Report No. 12 2006-07, 28 November 2006, pp 13-16, 39, Department of Family and Community Services, 'Annual Report 2000-01, Output Group 1.1: Family Assistance,' viewed on 26 June 2007 at http://www.facsia.gov.au/annualreport/2001/2/1/1.1.html.

27 Dunlevy S, 'Catch 22 debt trap snaps shut,' *Daily Telegraph*, 19 February 2003, p 21.

28 ANAO, *Management of Family Tax Benefit Overpayments*, Audit Report No. 12 2006-07, 28 November 2006, p 21.

expect taxpayers to focus on their tax position throughout the year and adjust their spending in response is not realistic.

7.38 Rather, people tend to make decisions intuitively and, recognising this, then make other arrangements to compensate. As one commentator has stated:

> …people tend to favour immediate benefits over more distant, less certain costs.
>
> This means humans often make choices they come to regret. They have a problem with self-control, which ranges from spoiling your appetite by eating too many nuts before dinner to …being unable to save…
>
> Because they recognise their self control problem, people commonly resort to what behavioural economists call 'commitment devices' intended to constrain their future behaviour in desirable ways.
>
> Conventional economists would regard most of these devices as irrational – for instance, failing to claim certain tax concessions through the year so they are returned as a higher annual tax refund, which is more likely to be saved.
>
> Given people's desire to overcome their own frailties, however, to label these efforts irrational merely demonstrates the labeller's incomprehension.[29]

7.39 In hearings, the Committee received evidence consistent with this. The ATO stated that taxpayers enjoy receiving a refund at the end of the financial year:

> The other thing that may be of interest to you there is those comments in relation to preference for a refund, because …you can adjust and finetune what is being withheld from your pay. But we did some research a few years ago—and it did surprise us—around whether, if it was very small amounts, people would prefer not to be lodging tax returns. The answer came back that, even if it was only a $10 refund, they would prefer to have a refund, in general, but if it was a $10 debt it would be okay not to lodge a tax return…[30]

29 Gittins R, 'Our nanny state's bright idea: ban the light bulb' *Sydney Morning Herald*, 26 February 2007, p 21.

30 Granger J, transcript, 22 June 2006, p 12.

7.40 The ATO's research showed that taxpayers believed that the refund was 'their one chance to recoup "their" money from the system.'[31]

7.41 Academic research confirms taxpayers' preference for lodging a return and receiving a refund. Atax at the University of New South Wales conducted a survey of people under the age of 24. They concluded:

> Although the participants were superficially attracted to the concept of not needing to lodge a return, virtually everyone decided that they would prefer to stay with the current system after thinking about the concept further. Many participants independently used the word 'control' in relation to that decision…[32]

7.42 This evidence and the example of FTB suggests to the Committee that not only is a measure of over collection in PAYG prudent for both the Government and taxpayers, but that taxpayers prefer it as well. Therefore, the Committee believes that the ATO should maintain a modest level of over collection in PAYG.

## Interest on over collections

7.43 Generally, the ATO pays interest on tax related amounts where the taxpayer has lodged a document and crystallised a tax amount. Interest is not paid under PAYG or where a taxpayer receives a tax credit. The interest rate is the base rate discussed in chapter six, namely the Reserve Bank's monthly average yield of 90-day Bank Accepted Bills. During 2006, the base rate was approximately 5.5% and it is now approximately 7.7%.[33]

7.44 The ATO is required to pay overpayment interest in the following circumstances:

- a taxpayer pays the tax required in their assessment, and the ATO then amends the assessment, reducing the tax liability
- the ATO takes more than 30 days to pay an income tax refund after a taxpayer lodges their return

31 Coleman C, 'Tax refund versus tax return?' Atax UNSW, Personal Income Tax Reform Symposium, April 2007, p 10, viewed on 8 May 2007 at http://www.atax.unsw.edu.au/research/pitr-symposium-07/papers/Paper_13-Coleman.pdf.

32 Id, p 11.

33 Treasury, sub 51, p 15, Reserve Bank of Australia, 'Interest Rates & Yields: Money Market & Commonwealth Government Securities,' viewed on 19 March 2007 at http://www.rba.gov.au/Statistics/HistoricalInterestRatesYields/2008.xls.

- the ATO takes more than 14 days to refund a running balance account following the lodgement of a correct business activity statement (BAS).[34]

7.45 Following an income tax assessment, taxpayers receive early payment interest where they pay the amount more than 14 days before the due date.[35] The Committee understands that the ATO usually gives taxpayers at least 21 days to pay an amount under an assessment.[36]

7.46 CPA Australia[37] and the Inspector-General of Taxation raised concerns that the ATO withholds large amounts of funds that are eventually repaid to taxpayers ($19.3 million in 2006-07[38]), which do not attract any interest. The Inspector-General argued this constituted an anomaly in relation to PAYG. If a taxpayer does not meet their PAYG obligations or make a sufficiently large error in calculating their PAYG amounts, they are subject to GIC. However, the Government does not pay interest on PAYG refunds and only pays interest in the circumstances listed above. The Inspector-General also noted that:

> - Even if the end of year position shows that the taxpayer did not need to provide for a liability, the compounded GIC charged on unpaid instalments remains compounding on the taxpayers PAYG account. Effectively, this is interest on monies that were never needed to be paid. Taxpayers can apply for remission; even if they get it, this can involve cost and delay…
> - Paying tax instalments by withdrawing investment capital results in loss of income for taxpayers. Accountants say that PAYG is fleecing small business of its capital.[39]

7.47 The Committee considered whether the ATO should pay interest on tax paid that is ultimately refunded to taxpayers. However, the Committee decided against this approach for a number of reasons. For example, the relationship between taxpayer and the ATO is not the same as that between a bank and a client. In the context of debt recovery, the ANAO summarised the taxpayer/ATO relationship as follows:

> Taxpayers' relationship to the ATO is different to the relationship between a private sector firm and those to whom that firm extends credit. Taxpayers' relationship to the ATO is not a market-based relationship. People are required by law to pay tax and the ATO is

34 Treasury, sub 51, p 15.

35 Treasury, sub 51, p 15.

36 Section 204 of the *Income Tax Assessment Act 1936*.

37 CPA Australia, sub 36, p16.

38 ATO, *Annual Report 2006-07*, p 39.

39 Inspector-General of Taxation, sub 48, p 15.

> in no position to withhold supply as a means of collecting debt, as are other creditors.[40]

7.48 Banks paying interest on deposits is based on the economic principles of trade and exchange. Banks lend on the basis of their deposits and earn revenues and profits on this lending. This dynamic does not apply to tax, where taxpayers have a legal obligation to pay.

7.49 Another reason why the Committee does not support the ATO paying interest on over collections of tax is that the Government will have to increase taxes to pay for it. For example, in 2006-07, the ATO refunded $19.3 billion to taxpayers. Using the ATO's 2004-05 data above, 61.3% of total refunds involve refunds on money paid by taxpayers. Applying this figure to $19.3 billion gives a total of $11.8 billion subject to interest. Assuming the ATO holds these funds for an average of 12 months[41] and pays 7.7% interest, the Government and Parliament will need to increase the ATO's budget by $909 million. The Committee is not convinced that it should impose an additional revenue burden on the community of almost a billion dollars so the ATO can pay interest on PAYG refunds.

7.50 Another reason why the Committee does not support the ATO paying interest on PAYG refunds is that many taxpayers enjoy receiving a refund in the first place. If taxpayers are happy to receive the refund as a form of enforced saving (see above), then the Committee does not see why the ATO needs to provide an additional benefit to taxpayers in the form of interest.

7.51 The final reason why the Committee does not support interest on refunds is that the system gives taxpayers a way of changing their PAYG amounts. As noted earlier in the chapter, this applies for both PAYG withholding and instalments.

7.52 The Committee notes that PAYG instalment taxpayers face significant risks in changing their PAYG amounts. If their instalment amounts are less than 85% of their final tax, they are subject to GIC. The National Institute of Accountants stated:

> The tax agents know that they could vary an instalment but often they do not because of the risk of penalties. If you vary the instalment and, for instance, the end result of the year is that your

40 ANAO, *The Management of Tax Debt Collection*, Audit Report No. 23 1999-2000, 20 December 1999, p 41.

41 This equates to taxpayers lodging their returns six months after the end of the financial year. It is assumed that taxpayers overpay evenly throughout the financial year. In effect, this means that they make a single overpayment half way through the financial year in question.

> tax is not within 85 per cent of the varied amount you are going to pay then you are up for penalties. Members that I speak to do not recommend a variation instalment, unless it is to nil—where they know that someone has gone into a loss situation. The issue is around this 85 per cent threshold and the risks that threshold creates.[42]

7.53 The problem for many taxpayers appears to be planning and managing their cash flow and tax liabilities. For example, in both its debt collection report in 1999 and its micro-business debt report in 2007, the ANAO stated that cash flow was a major contributor to tax debt.[43]

7.54 In other words, it appears that many PAYG instalment taxpayers prefer not to reduce their overpayments due to the challenges in predicting and managing their cash flow. Businesses that are better at planning and monitoring their cash will enjoy a competitive advantage because less of their resources will be held by the ATO.

## Common standards of practice

### Compliance issues

7.55 Parties to the inquiry interpreted this term of reference in one of two ways. Some believed this topic referred to the ATO's compliance activities (such as audits and remitting penalties and interest). Others looked more widely at the ATO's operations overall, including its advice role.

7.56 Where submissions expressed concern about common standards of practice, they focussed on the consistency of the ATO's compliance activities.[44] This report examines compliance activities such as audits in chapter five. In chapter six, it examines the ATO's approach to remitting penalties and interest. The remainder of its operations appeared to be of less concern due to it rationalising its operations.[45]

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42 Ord G, transcript, 25 August 2006, p 8.

43 ANAO, *The Management of Tax Debt Collection*, Audit Report No. 23 1999-2000, 20 December 1999, p 42, ANAO, *The ATO's Administration of Debt Collection – Micro-business,* Audit Report No. 42 2006-07, 12 June 2007, p 41. The ATO defines a micro-business as having an annual turnover of less than $2 million (p 11 of the micro-business report).

44 Taxation Institute of Australia, sub 40, pp 7-8, Resolution Group, sub 42, pp 11-15, Inspector-General of Taxation, sub 48, pp 12-14.

45 CPA Australia, sub 36, p 14, Institute of Chartered Accountants in Australia, sub 37, p 3, National Institute of Accountants, sub 31, p 6.

## Rationalisation of ATO operations

7.57 Over the last 10 years, the ATO has moved from a regional structure (duplicating the same expertise in each state) to a national structure where a certain expertise may only exist in one or a few states. In its submission, CPA Australia gave an overview of this process:

> [Consistency] may have been a problem to a greater extent in the past when the ATO operated via semi-autonomous state offices in which various ATO services (eg issue of rulings) were effectively duplicated in each office. One upshot of this administrative arrangement appeared to be a lack of co-ordination in the issue of rulings such that different rulings could be issued in some cases by different state offices on the same or similar topics.
>
> Problems of this kind in the private binding rulings area may have contributed to some of the problems with mass marketed schemes in the mid-1990s. However, as part of the clean up of those issues, the ATO moved to a new administrative framework whereby rulings and other ATO services are now provided on a single national basis notwithstanding that such services are still being provided on an operational basis via state offices.
>
> Insofar as we are currently aware, the ATO generally appears to adopt uniform administrative practices across the whole of Australia, although we note that individual cases are sometimes brought to our attention where matters may have 'slipped through the cracks.'[46]

7.58 This rationalisation and increased consistency has come at a cost. At the Launceston hearings, one accountant stated that reducing the breadth of ATO expertise in Tasmania made it more difficult to build links with it:

> In 1985, there was a fully functioning tax office in Hobart, and it had complex audit, high-level advice areas, individual advice areas and so forth. All tax agents in this state knew exactly who was in what area, and they could resolve their issues. Our firm even got the tax officers to come along to our training days to train us on things, to work out issues and so forth. Here we are 21 years later, with exceptionally complex tax legislation, and we do not know anybody in our tax office with whom we can speak to resolve an issue. That cannot be productive…[47]

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46 CPA Australia, sub 36, p 14.

47 Wright I, transcript, 24 August 2006, p 22.

7.59 At a Senate Estimates hearing in 2007, the ATO noted there are management efficiencies in moving away from a regional structure. The ATO discussed the example of closing down a four-person debt legal team in Hobart:

> … when you do not have a critical mass and you have people who go on leave and you have four covering a small group of people, it is hard to manage that effectively. There is an issue of having specialisations in areas where you can have more of a critical mass in Melbourne. On the other hand, we are trying to build Hobart as a centre for a lot of our superannuation work, and you will have to find people in Melbourne who will have to put up with people from Tasmania going there on some of their superannuation processes. When you run a large organisation across the country and you have a system that is nationally based and not regionally based, you have a whole range of those issues. What you have to do is try to make sure that you have a number of bases covered. One base is of course the level of service you can provide, and that has to be satisfactory. Secondly, you also have to make sure that you have a critical mass to go forward. You have to have some sort of succession planning and some level of specialisation. And the smaller the group the harder it is to provide that, even in terms of their own training and development.[48]

7.60 In summary, the shift away from a regional structure has had benefits in producing efficiencies for the ATO and ensuring that its advice and administrative practice are more consistent. However, it has made tax agents less efficient through reduced local links with the ATO. On balance, the Committee is of the view that the ATO has taken the right decision, mainly because greater consistency is fairer on taxpayers.

## Conclusion

7.61 The ATO faces a particular challenge in collecting tax debt. It cannot withhold supply from taxpayers and so does not have many options apart from traditional debt collection activities. Therefore, the PAYG system has taken a preventive approach by encouraging overpayments that are returned to taxpayers after they lodge their return. The Committee notes that many individuals are comfortable with this sort of commitment

48 Senate Standing Committee on Economics, Budget Estimates, D'Ascenzo M, transcript, 29 May 2007, p 42.

device. Further, PAYG instalment taxpayers have the option of conducting their own ‘squaring up’ when they lodge their final BAS for each financial year. Therefore, the Committee believes that the current framework strikes a reasonable balance between the interests of taxpayers and government.

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