NATIONAL INSTITUTE OF ACCOUNTANTS

22 September 2006

Mr Tony Smith MP
Chairman
Joint Committee of Public Accounts and Audit
PO Box 6021
Parliament House
CANBERRA ACT 2600

Email: jcpa@aph.gov.au

Dear Mr Smith,

Re: Inquiry reviewing certain taxation matters – supplementary submission

Following evidence to the Joint Committee on the 25th of August 2006, on the above inquiry, the National Institute of Accountants (NIA) undertook to articulate the concerns tax agents have with the Child Care Rebate (CCR). In gathering information for this supplementary submission, the NIA consulted with members and the other professional accounting bodies. In particular the NIA would like to acknowledge the assistance of Keith Clissold of the Association of Tax and Management Accountants and Garry Addison of CPA Australia.

In summary, the level of frustration tax agents have towards the CCR system cannot be underestimated. This frustration is borne partly out of how the administration of the system (between different government agencies) has been implemented, problems with the legislation, inadequacies with the systems of the Tax Office and the Family Assistance Office, lack of understanding by taxpayers and possibly child care centres, lack of knowledge about the CCR on the part of tax agents and taxpayers and inadequate information being distributed on a timely basis by the ATO. The inadequacies of the administration of the CCR again demonstrate the risks governments run of using multiple agencies with quite different foci to implement social welfare policy and thus involving tax agents in the process.

This concern was articulated in the recent "Rethinking Regulation", the report of the "Taskforce on Reducing Regulatory Burdens on Business". In its recommendations on reducing the cumulative burden of tax compliance, the Taskforce recommended that the Government should have as one of its priorities when developing future tax changes:

> *"Direct expenditure, including the social security system and direct grants, should be used to achieve equity objectives and compensate for tax changes."*

In expanding upon its position, the Taskforce stated that tax is "often less efficient in achieving equity objectives than direct expenditures and grants." Further, greater use of "direct expenditure and grants" in preference to the tax

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system "would significantly reduce tax complexity" which is often "unnecessary to achieve the policy objectives". Importantly, the Taskforce stated *"Removing the interaction would simplify the tax system and reduce compliance costs, without reducing the benefits available to welfare recipients".*

The 30% CCR is designed to cover 30% of out of pocket expenses for "approved" child care up to $4,000 per child. The rebate (which is not means tested) can be claimed in the 2005-06 income tax return, if a person has

- Used "approved" child care in 2004-05;
- Received the Child Care Benefit; and
- Passed the Child Care Benefit work/training/study test.

The ATO encourages people to confirm their Child Care Benefit entitlements and child care fee information by contacting the Family Assistance Office (FAO).

The difficulties tax agents are experiencing with this new initiative, when claiming it on behalf of clients (via the individual income tax return) can be summarised as follows:

- The information that is available to tax agents through the Tax Agents' Portal is frequently not accurate or there are differences in the information the taxpayer has and the FAO provide through the Portal.

  The Tax Agents' Portal can also display the message "No details recorded". In such situations, the taxpayer or agent should contact Centrelink prior to lodging their tax return to firstly confirm that "approved child care" as opposed to "registered child care" has been used and if the child was in "approved child care" in 2004-05, to request Centrelink to update the information they supply to the ATO.

  This not only delays the processing of tax returns, affecting how quickly taxpayers can get their refunds, but also is an unnecessary reverse workflow issue for agents.

- Transferring benefits to spouse. As the 30% CCR is a rebate or tax offset, it can only be applied to reduce a taxpayer's tax liability to nil. Any unused portion of the rebate (because of for instance, low taxable income) is wasted unless the taxpayer's spouse has taxable income. In such cases the unused portion of the rebate can be transferred to the spouse.

  Such transfers have been problematic for agents because it is usual for spouses to have their tax returns prepared and lodged by their agents at the same time. In situations where both spouses' returns are lodged on the same day, the ATO's systems may not allow a transfer to the other spouse (as it depends on whose return is assessed first). The ATO now advises tax agents to lodge the return of the primary claimant first and wait a few days to lodge the secondary claimant's return to allow the transfer to be effective (although this does not always work). This is because the unused amount can only be transferred after the primary claimant's assessment has issued.

To overcome the issue where the secondary claimant's assessment issues before the primary claimant (and hence the transfer is not effective), the ATO will automatically amend the secondary claimant's assessment. The ATO state that most amendments will issue within two to three weeks of the primary claimant's assessment being issued.

- Amending the primary claimant's return. If the primary claimant's return has a credit amendment post lodgement, then the primary claimant's entitlement to child care rebate may be automatically increased in some circumstances (eg. where previously the primary claimant did not have any or sufficient taxable income to benefit from the rebate).. In situations where there has been a transfer to a secondary claimant, this can lead to an amendment of the latter's assessment to reduce the amount of the rebate that they previously received (by the amount of the increase in the rebate of the primary claimant. As the secondary claimant will have a debit assessment for overclaiming the rebate, it is possible that the ATO will apply interest under the General Interest Charge (GIC) provisions) to the tax debt raised as a result of transferring back the rebate to the primary claimant.

- Disputing FAO amounts. It is apparently a difficult process to dispute the FAO amount. If a taxpayer is successful in disputing an amount then there are concerns about the speed in which the FAO advises the ATO of such an update.

The ATO is aware of these issues and have published information (on the 24th of August 2006) to help agents overcome these problems. However, the transfer issue in particular still remains a problem causing reverse work flows for practitioners (such as handling client queries, etc), even though the ATO is automatic only amending assessments in such situations.

Another important issue that has been identified is that a substantial number of taxpayers who are eligible for the CCR have not claimed the rebate in their tax returns (even though they apparently have received a letter from Centrelink/FAO advising them of their entitlement). Of these returns, a significant proportion were prepared by tax agents. Please contact the ATO to confirm this information.

If this information is correct, it raises the question of how those people who have failed to claim the CCR can receive their entitlement? Tax law requires each of the taxpayers affected to apply to the ATO for an amended assessment.

The ATO/FAO need to inform those taxpayers who may not have claimed their entitlement. We understand that where the ATO have identified that an entitlement may exist but has not been claimed that they are stating that on the relevant notice of assessment sent to the taxpayer. It is unclear though whether this is encouraging people to claim their entitlement through an amended assessment.

To assist in overcoming this issue, it has been suggested that the ATO should issue a list to agents of all their clients that may be entitled to the rebate. This list should specifically show agents the names of clients that have lodged but have not claimed the rebate. The ATO must accept that because agents will have to "chase up" these clients and prepare amended assessments in each

case that this will impact on the affected an agents' ability to meet their 2006/07 lodgement commitments.

Given the potential number of people that have failed to claim the rebate, the ATO may have to consider a method to "fast track" claiming of the rebate in these situations.

The above information highlights two major issues:

- How to resolve the problems identified for this year; and
- How to improve the CCR in future years?

To resolve the current year's problem, the ATO and the FAO could take action along the following lines:

- Keep promoting to taxpayers that are entitled to claim the rebate their entitlement and to emphasise to such people what evidence they need to take to their tax agent to claim the rebate;
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- The FAO and the ATO (without prompting from agents) could, where appropriate, identify deficiencies in the information the FAO shares with the ATO and update it, particularly where the information for a taxpayer states "No details recorded".
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- While the ATO are tackling the transfer issue through automatic amendments, they should recognise that this issue is generating reverse workflow issues for agents; and
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- The issue of amending the primary claimant's tax return, and the impact that may have on the secondary claimant is problematic, particularly as it could create a tax debt for the secondary claimant and hence GIC on that debt. It may require a change in law so that any amendment to the primary claimant does not affect their previously calculated entitlement to the rebate (and therefore not impact on the rebate transferred to the secondary claimant).

To improve the CCR for future year's, the NIA recommends that the policy be thoroughly reviewed. Such a review could look at the possibility of:

- Discontinuing the CCR and replacing it by an appropriate increase in the existing Child Care Benefit payment.. This would mean that the FAO would solely administer the policy, removing the nuisance value the rebate has added to the tax system.
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- Removing the current restriction that prevents a taxpayer from obtaining a cash refund of their full entitlement to the rebate where the rebate exceeds their tax liability. This would remove the need to transfer the rebate to the secondary claimant and remove the possibility of wastage of the rebate as well as the administrative/compliance problems associated with the current transfer system.
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- The possibility of the ATO or the FAO issuing the rebate without the necessity to make a claim. This would be similar to the ATO making the Family Tax Benefit supplementary payment upon lodgement of the

tax return. The information to calculate the Rebate is already with the FAO so why do taxpayers have to make a separate claim? If a taxpayer disagrees with the Rebate, then they can challenge the FAO.

I should also add that the ATO has recently indicated that it is currently considering a plan to move to an arrangement for paying the CCR without the need for taxpayers to make a claim through their tax returns for 2007. We understand that it may not have been feasible to adopt such an arrangement in 2006.

Should the Joint Committee require any further information or have any queries on this supplementary submission, please do not hesitate to contact me on (03) 8665 3114 or by fax on (03) 8665 3130 or by email on gavan.ord@nia.org.au .

Yours sincerely,

Gavan Ord
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