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Mr Russell Chafer
Secretary
Joint Committee of Public Accounts and Audit
Parliament House
Canberra, ACT 2600

By email: jcpa@aph.gov.au

Dear Mr Chafer

Review of a range of taxation administration issues in Australia

CPA Australia welcomes the opportunity to make the following submission to the Joint Committee of Public Accounts and Audit. (JCPAA). As Australia's pre-eminent professional association, representing the diverse interests of more than 108,000 finance, accounting and business advisors, we are committed to working with governments and government agencies to ensure government economic and social policies foster an environment that facilitates sustainable economic growth.

CPA Australia's major recommendations are as follows:

Part A

- **Reducing tax law complexity** – the government to clarify the timing of completion of the plain-English re-write of the Income Tax Assessment Act 1936 (ITAA 1936) and introduce an annual or periodical Technical Clarification Bill into Parliament to expedite early resolution of legislative anomalies

- **Self-Assessment** - the government give consideration to a move to a modified self-assessment system for most individual and small business taxpayers to give them greater certainty and reduced compliance costs

- **Enhancing ATO advice services** - the ATO to upgrade its technical advice services to agents to assist them in dealing with the more complex technical issues on behalf of their clients, particularly SME clients

- **Simplified tax system -** the annual turnover threshold for determining STS eligibility to be increased from $1 million to at least $5 million and appropriately indexed going forward

- **Employer/contractor issues -** the ATO to report on the effectiveness of its 'status of the worker' decision tool in 2006 and, if successful, liaise with State/Territory revenue authorities to implement a similar tool in the pay-roll tax and workers' compensation areas to assist compliance by business taxpayers

- **Personal services income rules -** the current uncertainty regarding the scope for PSBs to alienate personal services income needs to be clarified as soon as practicable either by the ATO and/or via an implementation review of the PSI provisions by the Board of Taxation

- **Thresholds -** the Government to implement a policy of indexing thresholds to the consumer price index (CPI)

- **Tax/welfare interaction -** the Government to resolve the current problems with Centrelink with respect to claiming of family tax benefits (FTBs) via the tax system. The Government also needs to consider reviewing its current strategy of providing benefits to taxpayers via the tax system and investigate alternative payment arrangements including via the social security/transfer system, and

- **Common mistakes in BAS/GST returns -** greater assistance be provided to small business taxpayers to reduce errors in BAS returns by way of increased education and/or via other measures including the introduction of simpler GST rules for such taxpayers in some areas

- **Operation and Administration of the Pay As You Go System** - while substantial reform of the personal tax system might be necessary to fully address some of these issues, the current position could be ameliorated in the short-term by appropriate adjustments/changes to the GDP uplift arrangements and the PAYGW schedules.

Part B

- **FBT car parking -** an optional standard valuation for car parking to be implemented to assist in resolving the existing issues and reduce compliance costs faced by businesses, and

- **FBT Minor and infrequent benefits -** the current $100 threshold for minor/infrequent benefits to be increased to at least $500 and indexed annually in line with average weekly earnings (AWE).

- **FBT/FTB interaction** - the government to review the current range of reportable benefits to determine their appropriateness, particularly from the standpoint of whether all such benefits confer a real advantage on the employee; and take appropriate action to ensure that employees are made aware of the full implications of receiving reportable fringe benefits

We would welcome the opportunity to discuss these issues with the Committee at an appropriate stage. In the meantime, please do not hesitate to contact me or Garry Addison FCPA (Senior Tax Adviser, ph. 03 9606 9771) if you have any queries.

Yours sincerely

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Submission to the Joint Committee of Public Accounts and Audit on certain taxation administration Issues

Introduction

While the issues raised by the Joint Committee of Public Accounts and Audit (JCPAA) relate to tax administration, it is both important and useful in addressing these issues to consider them in the context of the various levels through which the tax system impacts on the taxpayer population. These levels are as follows:

- tax policy
- tax legislation
- tax law interpretation, and
- tax administration.

The Australian Taxation Office's (ATO) administration of the income tax system is not the not the only source of problems with the existing system but they continue to be significant. For example, a recent survey of tax agents in the context of a joint ATO /accounting and tax professional bodies 'State of the Industry Research' program indicated that the major issues of concern to the profession in 2005 were:

- complexity/rapid changes to tax legislation
- compliance burden
- penalty regime
- professional indemnity costs, and
- difficulties in attracting/retaining quality staff, and
- ATO lack of understanding of pressures on tax agents.

Further details on this survey are available from the ATO's web site at State of the industry research - understanding tax agents (summary) – 2005.

Tax administration issues impact on all taxpayers via high compliance costs but the impact on SMEs and smaller firms generally is greater since their tax affairs are generally quite complex and compliance costs are a fixed cost. Moreover, small businesses generally lack the financial resources to seek the high level professional advice required to effectively navigate Australia's complex tax laws.

Tax policy

Unfortunately, the net effect of tax policy in recent years has been to increase compliance costs rather than reduce them. This reflects the fact that reducing the compliance burden on business (and taxpayers generally) has not been the highest priority in reforms over the past 20 years or so. In particular, the base broadening that has occurred in both the income tax and indirect tax areas has significantly complicated the tax system. To significantly ameliorate this impact is both very difficult and very unlikely in the short-term.

Tax legislation

Most of the tax system complexity is reflected in Australia's tax legislation. The income tax laws alone run to more than 8,000 pages not including the related tax administration and treaty acts. The plain-English re-write of the *Income Tax Assessment Act 1936* in the 1990s was only partially completed and is now contained in the separate *1997 Assessment Act*.

Tax law interpretation

The ATO is responsible for the interpretation and general administration of the income tax and other Federal tax laws including fringe benefits tax (FBT). The complexity of this task is reflected in the enormous volume of Taxation Rulings and Tax Determinations issued by the ATO as well as other similar products such as ATOIDs, PSLAs etc.

Tax administration

This refers to all the other services provided by the ATO, some of which support agents and their clients (such as education activities via publications, etc) and others (such as compliance activities including tax audits) which may simply exacerbate the compliance burden on them.

While tax agents are agents of the taxpayer, they play a significant role in tax administration. There are currently around 26,000 registered tax agents of whom about 14,000 are classified as active. Tax agents lodge around 75 per cent of individual income tax returns (ITRs) and 97 per cent of business returns.

Recent changes/developments

The above problems are well known and both the Government and the ATO have moved in recent times to ameliorate the impact of the compliance burden on taxpayers and agents. Some of the more important initiatives include:

- changes to the BAS system in early 2001
- improvements to consultative arrangements on new tax laws
- establishment of the office of the Inspector-General of Taxation to review systemic problems in tax administration
- improvements to the operation of the self-assessment system to reduce uncertainty and compliance costs for taxpayers (ROSA)
- Board of Taxation implementation reviews of business tax reform measures
- the plan to reduce the size of the tax law by 30 per cent by repealing inoperative provisions (as announced by the Treasurer on 24 November 2005)
- the introduction of a wide range of electronic services for dealing with the ATO including the tax agents and business portals, and
- improvements in ATO service delivery via the 'easier, cheaper and more personalised' program.

Notwithstanding these initiatives/efforts, much still remains to be done to reduce the ongoing compliance burden on business taxpayers and their advisers.

Specific JCPAA Issues - Part A

A. Impact of the interaction between self-assessment and complex legislation and rulings

This general issue was, of course, the subject of the Government's recent ROSA review and we note that the changes arising from that review should reduce uncertainty and compliance costs for taxpayers in line with the Government's intentions such as:

- providing a better framework for the provision of ATO advice and ensuring that such advice is more accessible and timely, and binding in a wider range of cases;
- reducing the periods allowed for the ATO to increase to increase a taxpayer's liability in a wide range of situations (eg. a reduction from four years to two years for most individual and STS taxpayers with four years generally for other taxpayers except where fraud or evasion is involved);
- mitigation of interest/penalty consequences of taxpayer errors arising from uncertainties in the self-assessment system; and
- provision for future improvements through better policy processes, law design and administrative approaches.

As noted above, in a recent survey, tax agents nominated tax law complexity coupled with the continual changes to the tax legislation as the most critical elements of the compliance burden faced by themselves and their clients. This is particularly the case where small business taxpayers operate in a self-assessment environment where they may be subject to a post-assessment audit by the ATO, albeit now for a shorter period (2 years) than previously as a result of the ROSA changes.

Possible options for dealing with this problem going forward include:

1. Reducing tax law complexity by way of tax law simplification, including improvements in tax law drafting and early removal or resolution of tax law anomalies
2. changes to the self-assessment system
3. enhancements to ATO information and advice services
4. improving the attractiveness of the STS regime
5. addressing problems in those areas of tax law which impinge most significantly on individual taxpayers and SMEs.

These options are now discussed in turn.

1. Reducing tax law complexity

While the Treasurer's recent announcement that the Government would move to reduce tax law by 30% through the removal of inoperative provisions[1] is necessary and useful, the impact on the overall compliance burden on taxpayers and their advisers of such a change is unlikely to be significant given that the provisions being removed are generally no longer relevant.

[1] (basically those provisions in the Income Tax Assessment Act 1936 that have been rendered inoperative or redundant as a result of the plain English rewrite of that Act undertaken in the 1990s)

Adoption of a 'coherent principles based drafting' (PBD) approach to tax legislation (as distinct from 'black letter law') has recently been trialled in the Government's proposed TOFA reforms. A major problem with PBD appears to be a lack of certainty which would need to be dealt with either by regulations and/or ATO rulings but it is unclear in the TOFA situation as to how this would be done. Tax practitioners would not favour leaving this to the ATO. In particular, if the TOFA exposure draft legislation is an example of PBD then one must conclude that the PBD approach to legislative drafting will inevitably increase the number of rulings and regulations required, as the law will be otherwise bereft of the required level of certainty necessary for it to effectively operate.

A further issue arises in respect to the timing of the completion of the plain-English re-write of the 1936 Act in the light of the current PBD trial. A question may arise as to whether the commencement of this rewrite will be affected by the availability of the necessary drafting resources and/or the extent to which the PBD approach may need to be used in the re-write. It is desirable for the Treasurer to clarify the timing of this rewrite as soon as possible given the significance of such a project in the context of the ongoing task of tax law simplification.

In conjunction with Treasury, the ATO has recently established a process for dealing with legislative anomalies via a designated Committee (Technical Issues Management Subcommittee (TIMs)) of its National tax Liaison Group (NTLG). If the ATO concludes it is unable to resolve the matter administratively and the proposed remedy is consistent with the underlying policy of the law, then the issue is referred to Treasury via the relevant Treasury Minister for consideration of a legislative solution. CPA Australia believes that this process could be expedited if the Government agreed to the introduction of periodic Technical Clarification Bills.
A major advantage of a TCB approach is that it would overcome the problem associated with the current practice of including such changes in omnibus Tax Law Amendment Bills where such Bills may be delayed as a result of the need for closer scrutiny of some of the more controversial and/or substantive measures included in such bills. Given that TCBs would only be dealing with the rectification of legislative anomalies, it seems more likely that they could generally be given swifter passage through Parliament than TLABs.

Recommendation:

That the JCPAA recommends that the Government:

- clarifies the timing of completion of the plain-English re-write of the ITAA 1936, and
- introduce annual or periodical Technical Clarification Bills into Parliament to expedite early resolution of legislative anomalies.

2. Impact of Self-Assessment

Before the introduction of the current self-assessment system, the onus was on the ATO to be pro-active in determining income tax issues as they arose (or came to the notice of assessors). The ATO can afford to be more reactive given that self-assessment clearly places more responsibility on taxpayers and/or their advisers to get things right first time. Combined with a significantly more detailed and complex income tax and other tax laws, the current system arguably places significant and undue pressure on taxpayers and their advisers.

Despite the ATO's best efforts and intentions in providing rulings when requested, the practical issues for taxpayers and advisors mean 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, rather than minimising tax. For example, feedback from our

members is that most SME taxpayers are very reluctant to pay for the work involved in obtaining a private binding ruling (PBR).from the ATO.
In the absence of a PBR, however, the onus is on the taxpayer to get the matter right since the ATO does not have to take a position on a tax matter until after the event. The ATO response to encourage taxpayers to seek rulings is in many cases (eg. where individual and/or small business taxpayers are involved) simply unrealistic. Before the introduction of self assessment, it would have been incumbent on the ATO to make a decision on the matter at the time of assessment, which is probably when those matters should generally be resolved.

We acknowledge that the ATO has been working very hard in recent years to try to make things easier for taxpayers and agents. However, these efforts appear to be really made within the constraints of the current system, some of which have been designed by them, rather than stepping well back to look at the underlying system.

In the circumstances, therefore, it may be appropriate for the Government to consider a move to a modified self-assessment system for most individual and small business taxpayers to give them greater comfort that their returns have been assessed and relevant issues raised as appropriate before any final assessment is issued. We note in this context, however, that the recent move to a two year review period for individual and STS taxpayers goes some way towards meeting this objective.

Recommendation

That the JCPAA recommends that the Government give consideration to a move to a modified self-assessment system for most individual and small business taxpayers to give them greater certainty and reduced compliance costs.

3. Enhancing ATO advice services

Under present arrangements, agents seeking ATO assistance on tax law interpretation issues can only use one of the following options:

- ATO call centres
- ATO products/publications
- seek a private ruling from the ATO.

In the absence of an appropriate ATO ruling product, basic ATO publications such as fact sheets and guides are not of much assistance to practitioners in dealing with more complex issues, particularly in areas such as capital gains tax and tax consolidation. Moreover, private rulings are not considered commercially realistic because of the lengthy timeframes involved both in respect to the extensive preparation required (which would need to be charged to the client) to ensure an appropriate response and the time in which it takes the ATO to finalise a response (while the ATO has recently confirmed that its 28 day timeframe is invariably met in non-complex cases, this timing may still be difficult for SMEs in many situations, particularly where legitimate delays arise due to further information being required by the ATO before a matter can be finalised). There are also concerns regarding a pro-revenue bias in ATO rulings. in some cases.

Practitioners have, therefore, argued that there is a pressing need for something else from the ATO to bridge the gap between private rulings and the more basic service available from the call centres. Some possible solutions to this problem that should be considered by the ATO include:

- use of a secure messaging facility on the tax agent portal

- ensure that call centres adopt a stronger focus on technical matters rather than being simply confined to transactional issues
- establish a 'user pathway' to assist agents in dealing with SME tax technical issues (at a minimum, this should at least ensure a smooth path from the call centre to a relevant subject expert and/or to an appropriate tax centre of expertise, which could be assisted by appropriate CRM technology).

Given the importance and significance of the law complexity issue to practitioners and their clients, CPA Australia believes that resolution of this issue should be accorded high priority.

Areas where complexity is a particular problem for SMEs and further ATO guidance is required include:

- capital gains tax (particularly the small business CGT concessions which have recently been reviewed by the Board of Taxation, although neither the Board's report nor the Government's response to it are yet available)
- service entities
- trust losses legislation
- PSI/PSB rules (see further below).

Recommendation:

That the JCPAA recommends that the ATO upgrade its technical advice services to agents to assist them in dealing with the more complex technical issues on behalf of their clients, particularly SME clients.

4. Simplified tax system for certain small business taxpayers (STS)

The STS was introduced from 1 July 2001 to provide some simpler tax rules for certain very small business (micro-business) taxpayers (annual turnover of less than $1 million) in the tax accounting, depreciation and trading stock areas.

The STS was not well supported by small business in its initial stages since some of its main elements such as a mandatory cash accounting system and a simplified trading stock regime did not prove to be very attractive for most micro or small businesses. More recently, however, there have been several enhancements to the STS to encourage greater take-up by taxpayers including:

- allowing eligible taxpayers a choice whether to adopt accruals or cash accounting rules for tax purposes rather than being restricted to a cash accounting basis

- reducing the time limit for amending STS taxpayers' income tax returns under the ROSA changes from 4 to 2 years (except in case of avoidance or evasion), and

- introducing an entrepreneurs' tax offset of up to 25% on business-related income tax liabilities of STS taxpayers with an annual turnover below $75,000 (although the maximum offset is phased-down beyond the $50,000 turnover level).

Despite these changes, there is still only about 27 per cent of eligible taxpayers that have entered the STS. While this take-up could improve as small business owners become more aware of the recent changes, there are still some issues with the STS that need to be addressed. For example, some of the benefits of the pooling arrangements are reduced if an asset is sold within, say, four to six years of its acquisition since the seller has to trace back the depreciation written-off.

The complexity of the STS eligibility rules such as the special grouping provisions and other requirements could also be liberalised and/or aligned with other current tests since this imposes compliance costs on small business owners and their advisers, and probably discourages use of the STS. Different tests and thresholds currently apply to various small business concessions such as the CGT concessions, the various BAS concessions and other more specific carve-outs including the recent 'at-call' loans exclusion.

While there are varying definitions of small business, we are not aware of any classification or definition which would restrict the small business sector to a $1 million turnover limit. In fact, from a turnover perspective, it could be argued that either a $10 or $20 million per annum threshold would be a more appropriate benchmark the latter is the current limit for eligibility for the quarterly BAS system and, more recently, the carve-out from the application of the debt/equity tax rules to 'at-call' loans).

Accordingly, from the standpoint of reducing small business compliance costs, we believe that there is a strong case for increasing the STS threshold to an annual turnover of at least $5 million and that this revised threshold be appropriately indexed from the date of this change.

Recommendation

That the JCPAA recommend that the annual turnover threshold for determining STS eligibility be increased from $1 million to at least $5 million and be appropriately indexed going forward.

5. Addressing problems in those areas of tax law which impinge most significantly on individual taxpayers and SMEs

5(1) Employer/contractor issues

While most employer/employee relationships are readily identifiable under the standard common law rules, there are occasions where this is not clear cut, particularly in some industries such as building and construction, IT, film, and fishing, etc. The resultant uncertainties in respect to the precise income tax , super guarantee charge, pay-roll tax and work cover outcomes in such cases can impose undue compliance costs on many small businesses. While the New Tax System (NTS) sought to ameliorate these issues for income tax purposes by the introduction of the new ABN and PAYG regimes as well as the personal services income (PSI) rules, problems in this area still remain.

One reason for the current problems stem from a common misconception on the part of some employers and employees that possession of an ABN means that the holder is automatically a contractor rather than an employee. This is not the case since the precise status of a worker can still only be determined by considering all the relevant factors specified in the common law rules.

The ATO has sought to address problems in the income tax area via the development of a 'status of the worker' decision tool which has been designed to assist both parties to determine whether a worker is an employee or contractor. As this tool may also be useful to business taxpayers for pay-roll tax and workers' compensation purposes, it would seem desirable for State/Territory revenue authorities to liaise with the ATO at an appropriate stage to determine the scope for this to occur.

Recommendation

That the JCPAA recommend that the ATO report on the effectiveness of its 'status of the worker' decision tool in 2006 and, if successful, to liaise with State/Territory revenue

authorities on the scope for the same or a similar tool to be used in the pay-roll tax and workers' compensation areas to assist compliance by business taxpayers.

5(2) Personal service income (PSI) rules

The PSI rules were introduced with effect from 1 July 2000 to make it administratively easier for the ATO to prevent tax avoidance via the alienation of personal services income by contractors and other small business taxpayers.

The effect of the PSI rules is that those taxpayers who do not met various tests prescribed in the law (such as the results tests or other relevant tests including the 80% rule) are subject to the PSI rules (unless the taxpayer obtains a PSB determination from the ATO) and thus the relevant income is included in the assessable income of the individual concerned regardless of whether it is derived via a separate entity such as a partnership, company or trust.

The PSI rules also limits the type and amount of deductions that can be claimed by a non-PSB - type taxpayer.

An individual or other entity that satisfies the PSI rules will be taken to be conducting a personal services business (PSB). However, the ATO has indicated that the general anti-avoidance provisions in the income tax law (Part IVA) may still prevent the alienation of such income via splitting with associates and/or retention of income in a company (which is of itself a form of income splitting). Unfortunately, the potential application of the anti-avoidance provisions in this area creates considerable uncertainty and compliance costs for many contractors/small business entities. This problem actually extends back over two decades or more and the PSI rules have not done much to address the uncertainty.

In March 2003 following ongoing representations by CPA Australia and the other accounting and tax professional bodies, the ATO agreed to develop an appropriate test case program to seek to clarify the law in this area through the courts. Since then the ATO has subsequently conducted a review of the Part IVA provisions (including in respect to their application to PSBs) and the Tax Commissioner announced the outcome of this review in December 2005. The upshot of this review is that the ATO has now confirmed that it will not now apply Part IVA in either of the following two situations:

- ordinary 'husband and wife' partnerships which constitute a PSB (unless unusual features are present such as where a disguised employment relationship is involved or the use of a partnership is prohibited by regulatory or other laws); and

- retention of profits by companies, unless the remuneration paid to the relevant principal is not commensurate with the value of the services provided, or it is otherwise apparent that the purpose of the retention is to avoid/defer tax.

In this light, a revised test case program is being pursued with a focus on the following:

- disguised employment cases
- income splitting via trusts where the beneficiaries make no contribution to the derivation of the income
- use of more than one entity by a service provider where a single entity would be adequate for commercial purposes, and
- profit retention by companies outside of the limits outlined above.

Early clarification of this matter for PSBs is a priority in order to bring greater certainty into this area. The necessity of this is twofold:

- currently many taxpayers are pressured into taking adverse positions (eg. by following long-standing ATO rulings such as IT 2503 and IT 2639) that arguably are

contrary to the law as they do not have the capacity to fight the ATO through the courts at some point in the future, and

- the need to reduce compliance costs for affected taxpayers.

However, given the length of time that has elapsed since the PSI test case program was originally announced and the impact of recent developments, it is now unclear as to whether the litigation approach is the most appropriate means to achieve this objective.

Accordingly, CPA Australia believes that consideration should now be given to an appropriate implementation review of the PSI provisions by the Board of Taxation.

Recommendation

The current uncertainty regarding the scope for PSBs to alienate personal services income should be clarified as soon as practicable either by the ATO and/or via an implementation review of the PSI provisions by the Board of Taxation.

5(3) Indexation of thresholds

There are a range of thresholds in both the income tax and GST laws which impact on SMEs and which broadly fall into one of the following two categories:

- those used to determine eligibility for simpler tax rules applicable to the designated eligible small business/SME taxpayers (examples include the GST registration threshold, the turnover thresholds in the BAS/PAYG regimes and the STS threshold); and

- other thresholds designed to carve-out a designated group of small business/SME taxpayers from more onerous tax rules essentially targeted at arrangements entered into by larger taxpayers (an example includes the carve out of certain SME taxpayers from the application of the debt/equity tax rules to 'at call' loans).

A major problem in this area is the general lack of any indexation arrangement or a review process to ensure that these thresholds are not eroded over time by inflation. To remedy this problem, CPA Australia believes that the various thresholds should be reviewed and appropriately adjusted and that the revised thresholds should be indexed for inflation from that date in line with either AWE or CPI adjustments.

Recommendation

The JCPAA to recommend that the Government implement a policy of indexing relevant SME thresholds to the CPI.

5(4) Tax/welfare interaction

Additional complexity has been introduced into the Australian tax system in recent years through the use of special arrangements such as tax offsets and family tax benefits (FTBs) and this complexity has increased compliance costs for small business taxpayers including tax practitioners.

The range of tax offsets now available include those for low income earners, seniors, mature aged workers, dependant spouse (housekeeper, etc), supporting parents, child care, certain medical expenses, private health insurance and small entrepreneurs. Certain other benefits such as FTBs, baby bonus and superannuation co-contributions can also be claimed via the tax system. Income tax averaging is also available to some classes of taxpayers with

fluctuating incomes and the farm management deposits scheme (FMD) applies to primary producers.

The scope for claiming FTBs through the tax system as well as through Centrelink has been a particular problem for tax practitioners and their clients largely due to the difficulties involved in obtaining appropriate information from Centrelink such as details of payments made to beneficiaries via payment summaries, etc.

It is clearly necessary, as a first step, to resolve the current problems with Centrelink. Secondly, we believe that the Government should review its current strategy of using the tax system as a vehicle for the delivery of social welfare type payments and/or other benefits to taxpayers either in the context of proposals for reform of the tax system and/or the social security system(s).

Recommendation

That the Government seek to resolve the current problems with Centrelink in respect to the claiming of FTBs via the tax system. The Government should also review its current strategy of providing benefits to taxpayers via the tax system and investigate alternative payment arrangements including via the social security/transfer system.

5(5) Common mistakes in BAS/GST returns

Ongoing GST complexities and problems for small business are reflected in the common mistakes made by small business taxpayers in BAS returns. These mistakes have been identified by us in our small business surveys and include the following:

- many small businesses identify themselves as either cash or accruals taxpayers when they register for GST but subsequently complete their BAS on the other basis
- poor recordkeeping in many businesses results in BAS errors, eg. small businesses that use cash takings to pay expenses may erroneously omit cash transactions when completing their GST liability
- small businesses often pay the amount due to the ATO but fail to return the BAS form
- many businesses claim input tax credits when purchasing a capital asset such as a motor vehicle but fail to recognise that the sale or trade-in of the asset is a taxable supply
- small businesses that prepare/lodge their own returns may run a greater risk of making errors and thus incurring interest and penalties
- many small businesses are incorrectly calculating the GST payable or input tax credits under the margin scheme (for properties acquired pre and post–1 July 2000) and then reporting incorrect amounts in their BAS
- claiming input tax credits when purchasing from suppliers who are not registered for GST or suppliers with no ABN or don't have appropriate source documents as evidence of an ABN
- overstating or overlooking private use of assets and over-claiming input tax credits
- incorrectly including wages and superannuation in the calculation of input tax credits

- incorrectly claiming 1/11th of total insurance premiums as an input tax credit notwithstanding that the relevant GST amount is usually specified in the premium notice, and

- incorrectly claiming input tax credits on hire purchase and lease arrangements since such claims can vary depending on the nature of the arrangement (i.e. whether a HP or lease) and, in the case of HP, whether the business lodges on an accruals or cash basis.

Given the persistence of the above problems, there is clearly a need for increased education of small business taxpayers on GST/BAS issues, particularly given that GST (unlike income tax) is a transactions based tax. In addition or alternatively, there may be a need for simpler GST rules for small business taxpayers in some areas, perhaps by way of an expanded STS as proposed above.

Recommendation

That greater assistance be provided to small business taxpayers to reduce errors in BAS returns by way of increased education and/or via other measures including the introduction of simpler GST rules for such taxpayers in some areas.

B. Application of common standards of practice by the ATO across Australia

This issue may have been a problem to 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'. Where practical compliance improvements are introduced (for example, under the ATO's 'Making It Easier To Comply' program), our understanding is that these improvements would apply uniformly across Australia, although the impact of such reforms could perhaps differ in the various states or regions depending on the proportion of affected taxpayers (eg. micro-businesses or SMEs) in those areas.

C. Level and application of penalties, and the application and rate of the General Interest Charge and Shortfall Interest Charge

We note that these issues were comprehensively addressed in ROSA and changes in respect to both penalties and interest arising from the review have recently been implemented.

Notwithstanding this, we have some concerns about the current operation of the failure to lodge on time (FTL) penalties, particularly in view of the ongoing problem in respect to non-lodgment of income tax returns, although apparent deficiencies in ATO systems and data collection in this area means that the position is not entirely clear. CPA Australia (and the other major accounting and tax professional bodies) are currently pursuing this issue with the ATO through its Tax Practitioner Forum (ATPF).

Following recent consultations with stakeholders (including CPA Australia), the Inspector-General of Taxation (IGT) has recently updated his forward work program to include this issue. Some points noted by the IGT in this regard include:

- information supplied by the ATO shows that many millions of non-lodged income tax returns have accumulated over recent years and that large amounts of revenue and refunds may be involved; and
- tax agents have expressed the view that the ATO's lodgement strategies are overly dependent upon leveraging the role of tax agents to put pressure on taxpayers to comply and that this may reflect other deficiencies in the system including with non-lodgment penalties.

A potential problem with the current FTL arrangements is that the penalties for those taxpayers who lodge later than the due date for lodgment (either directly or via a tax agent) seem to be more severe than in the case of a taxpayer who either fails to lodge at all or lodges very late. This is because the maximum penalty under the current FTL system arises when a return is 113 days overdue, although the general interest charge (GIC) continues to apply to any amount that remains unpaid after this period.

Further details on FTL penalties (including administrative guidelines) are contained in a Fact Sheet on the ATO's website. In the circumstances, therefore, the JCPAA may wish to indicate its support for the current action in this area and/or express a wish to be kept informed of developments.

D. Operation and Administration of the Pay As You Go System

CPA Australia believes that the PAYG instalment and withholding components of the current overall PAYG system require further refinements. Under the current system, the ATO effectively 'over-collects' $15 billion per year in additional withholding amounts. This additional money is then redistributed to taxpayers as tax refunds during the next financial year. This process places an undue burden on taxpayers who are denied access to their money during the year, but do not receive any interest on the foregone funds.

This over-collection problem is essentially the result of two issues. Firstly, the seven per cent uplift that is used for instalments based on GDP is excessive as a default increase in withholding requirements since this rate is more than twice the rate of inflation. This problem is often compounded by the unnecessary inflexibility in the GDP uplift arrangements which can be detrimental to many contractors and small business owners with incomes that fluctuate from year to year. These factors tend to operate as a significant disincentive to use of the GDP option and therefore defeats its primary purpose as being a means to ameliorate small business compliance costs.

Secondly, the withholding arrangements retain too much money. This is partially a factor of the deductions claimed at the end of the year process, and partly due to the complexity of the progressive rate structure of the personal income tax system and the ever increasing complexity of the tax offsets arrangements. While substantial reform of the personal tax system might be necessary to fully address some of these issues, the current position could be ameliorated in the short-term by appropriate adjustments/changes to the GDP uplift arrangements and the PAYGW schedules.

Recommendation

While substantial reform of the personal tax system might be necessary to fully address some of these issues, the current position could be ameliorated in the short-term by appropriate adjustments/changes to the GDP uplift arrangements and the PAYGW schedules.

Specific JCPAA Issues - Part B

A. Fringe Benefits Tax (FBT)

The current FBT rules impose significant compliance costs on employers, particularly SME employers. While there is an argument for a comprehensive review of the current rules given that the original legislation was first introduced in 1986 and has been amended many times since then to rectify apparent design flaws, we believe that such a review may be outside the scope of the JCPPA's current role. We suggest, however, that the JCPAA should at least consider two FBT issues (relating to car parking and minor/infrequent benefits) that have a significant impact on SME compliance costs.

1. Car parking

The FBT rules relating to 'on premises' car parking are difficult to determine, value and attribute to individuals and need to be simplified to reduce compliance costs. The cost of determining the lowest car parking fee at a commercial parking station within one kilometre of employer provided parking can be quite large, either in terms of time commitment from an employee undertaking the necessary investigation, or in paying an external consultant to obtain this information. The same issue arises in determining whether or not there is a parking station within one kilometre that charges more than the threshold amount. It is also often difficult to obtain accurate information from commercial car parks in respect to their car parking rates.

Alternatively, in most cases an exemption applies and thus there is no FBT liability so the benefit might just as well be made totally exempt.

Recommendation

That an optional standard valuation for car parking be implemented to assist in resolving the existing issues and reducing compliance costs faced by businesses.

2. Minor and infrequent benefits

The FBT rules allow for the exemption of benefits which are both minor and provided on an infrequent and irregular basis. Such benefits are defined as those with a value of less than $100 which are provided infrequently and/or are difficult to value.

The question of what is 'infrequent/irregular' is unfortunately quite subjective and can be time consuming (and thus costly) to assess properly. It has also become more of an issue since the introduction of reportable fringe benefits as employees now have a much greater interest in understanding the basis for the FBT treatment of particular benefits.

We also consider that the current $100 threshold for such benefits is far too low as it has not been varied since its introduction in 1986. Accordingly, we believe that the threshold should be increased to at least $500 and indexed annually in line with average weekly earnings (AWE).

Recommendation

That the current $100 threshold for minor/infrequent benefits be increased to at least $500 and indexed annually in line with average weekly earnings (AWE).

B. FBT/FTB Interaction

We note that this issue appears to be related to the more general tax/welfare interaction topic canvassed earlier in this submission.

Employers are required to record on payment summaries for employees the grossed-up taxable value of certain fringe benefits (other than excluded benefits) provided to employees during the FBT year, whee the value of the benefits provided to an employee exceeds $1,000. The relevant 'reportable fringe benefits amount' is used to determine a taxpayer's entitlement to certain income-tested benefits for the year including family tax benefit (FTB) payments.

While specific concerns on this matter do not appear to have come to our attention to date, we understand that it may be related to the effective marginal rate of tax being very high when government benefits start to be withdrawn as the taxpayer's income (including reportable benefits) climbs. It may also link with the fact that some reportable benefits are either not entirely within the control of the relevant employee and/or the implications of receiving such benefits is not fully understood by the employee.

Alternatively or additionally, it could be argued from a social policy standpoint that fringe benefits are not cash and thus may not actually aid the family, whereas family tax benefit (FTB) payments are cash intended for the family.

The policy rationale for the reportable benefits system presumably reflects the view that such benefits are in lieu of cash and thus should be taken into account in determining eligibility for social welfare and other related government benefits. If the issues mentioned above are the ones that have been raised with the Committee then the following options could be considered:

- the government to review the current range of reportable benefits to determine their appropriateness, particularly from the standpoint of whether all such benefits confer a real advantage on the employee; and

- appropriate action to ensure that employees are made aware of the full implications of receiving reportable fringe benefits (the onus for this may need to be imposed on the relevant employer and/or fringe benefits provider).

Recommendation

The following options should be considered:

- the government to review the current range of reportable benefits to determine their appropriateness, particularly from the standpoint of whether all such benefits confer a real advantage on the employee; and

- appropriate action to ensure that employees are made aware of the full implications of receiving reportable fringe benefits (the onus for this may need to be imposed on the relevant employer and/or fringe benefits provider).