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JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

Reference: Certain taxation matters

FRIDAY, 28 JULY 2006

SYDNEY

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JOINT STATUTORY COMMITTEE OF

PUBLIC ACCOUNTS AND AUDIT

Friday, 28 July 2006

Members: Mr Anthony Smith *(Chair)*, Ms Grierson *(Deputy Chair)*, Senators Mark Bishop, Hogg, Humphries, Murray, Nash and Watson and Mrs Bronwyn Bishop, Mr Broadbent, Dr Emerson, Dr Jensen, Miss Jackie Kelly, Ms King, Mr Laming and Mr Tanner

Members in attendance: Senators Humphries, Murray and Watson and Mrs Bronwyn Bishop, Dr Emerson and Mr Anthony Smith

Terms of reference for the inquiry:

To inquire into and report on:

Part A

The administration by the Australian Taxation Office (ATO) of the *Income Tax Assessment Act 1936* and *1997* (including the amendments contained in the *Tax Laws Amendment (Improvements to Self Assessment) Bill (No. 2) 2005)* with particular reference to compliance and the rulings regime, including the following:

- the impact of the interaction between self-assessment and complex legislation and rulings;
- the application of common standards of practice by the ATO across Australia;
- the level and application of penalties, and the application and rate of the General Interest Charge and Shortfall Interest Charge; and
- the operation and administration of the Pay As You Go (PAYG) system.

Part B

The Committee shall examine the application of the fringe benefit tax regime, including any "double taxation" consequences arising from the intersection of fringe benefits tax and family tax benefits.

WITNESSES

Committee met at 9.31 am

CHAIR (Mr Anthony Smith)—I welcome everybody here to the committee's second hearing of its inquiry into certain taxation matters within Australia. Today we begin with two agencies responsible for monitoring the operations of the Australian Taxation Office—the Inspector-General of Taxation, who is charged with improving the administration of tax laws for the benefit of taxpayers, and the Commonwealth Ombudsman, who, since 1995, has been responsible for correcting perceived imbalances between the tax office and taxpayers. We will also hear from a number of peak bodies representing the interests of finance, accounting, business and legal advisors and their clients, as well as from Taxpayers Australia, an organisation dedicated to informing and representing business and individual taxpayers.

I remind participants that the committee will be looking at policy and administration matters and is not seeking to act as a review panel for individual cases or grievances with the ATO. Before beginning, I advise witnesses that the hearings today are legal proceedings of the parliament and warrant the same respect as proceedings of the House itself. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of parliament. The evidence given today will attract parliamentary privilege.

[9.32 am]

BROWNE, Mr Damien, Senior Assistant Ombudsman, Office of the Commonwealth Ombudsman

McMILLAN, Professor John, Commonwealth Ombudsman, Office of the Commonwealth Ombudsman

VOS, Mr David, Inspector-General of Taxation

CHAIR—Welcome. Do you have any comments to make on the capacity in which you appear?

Prof. McMillan—I am also the Taxation Ombudsman.

Mr Browne—I am also a special tax advisor to the Ombudsman.

CHAIR—As always, I remind participants that only members of the committee can put questions to witnesses if these hearings are to constitute formal proceedings of the parliament and attract parliamentary privilege. I invite you to make opening statements before we move to questions and discussion.

Mr Vos—Thank you for asking me to lodge a submission with the inquiry, to appear before you today and to make a short opening statement. The committee's terms of reference are fairly broad, and I note that the chair has described this inquiry as 'a wide-ranging and comprehensive review into tax administration'. I welcome the committee's questions in that broad context and will do my best to assist. As with my submission, I ask that the committee note that the points I make today do not have the status of official findings by my office. I therefore neither provide advice nor make recommendations. Rather, I look forward to discussing issues which the committee might consider and explore and to offering my experience on matters of interest to the inquiry.

My role is to undertake reviews of systemic issues of tax administration which appear to need improvement. I am required to approach this role in terms of the principles of good tax administration, including simplicity, efficiency, transparency and, above all, fairness. The significant advances made by the tax office in efficiency and service levels in the years since self-assessment was introduced have made it a world leader in some of those areas. Significant improvements to the system have also been made by governments over the years. The Treasury submission to this inquiry has summarised these, including those implemented fairly recently as part of the review of aspects of self-assessment. More is needed, and some of this—notably the new regulatory regime for tax agents—is already on the agenda.

In this context, a central question for my role and any review of tax administration must be: does the tax office live out its espoused values of fairness and transparency in the way that it administers the system? The Treasury submission to the inquiry summarised the role of the tax office as being 'through a statutorily independent commissioner, responsible for the general

administration of tax laws, which includes their enforcement and providing advice on the commissioner's interpretation of them, as well as the day-to-day collection of revenue.' I would only add that the community expects this role to be undertaken objectively and without fear or favour from any quarter.

In this respect, I notice that the tax office from time to time seems to blur the gap between tax policy and administration. I note that the commissioner has recently said that the role of the tax office 'is that of implementing the policy objectives of tax legislation'. I have noted signs that the tax office is willing to interpret and administer the law in line with its view of policy even if the letter of the law does not adequately support it. There are also examples of the tax office being prepared to challenge court decisions because the law does not deliver policy intent, even though the legal advice of the Solicitor-General says that the correct path in that situation is to seek changes to the law. It is important for the commissioner to acknowledge to his staff and to the community that his role is that of tax administrator and enforcer and it is not his role to prop up deficient tax law where policy intent is not met in the law.

The new commissioner's emphasis on values as a foundation for his administration is to be welcomed. However, I have observed the tax office behaving in ways that could undermine confidence in its ability to be fair, transparent and to act in accordance with the rule of law. In particular, its refusal to apply the principle established in Essenbourne, now ratified in five other cases, is a poor reflection on its values and culture. Most worrying has been the consequential damage to many employee benefit arrangement taxpayers, which the tax office is at least belatedly acknowledging in its current letters to taxpayers.

In his opening statement to you on 22 June, the commissioner noted that a key approach for the ATO is 'to differentiate between taxpayers trying to do the right thing and those who are not'. I have noted in my submission however, that there is a need for more explanation on tax office decisions to apply different compliance approaches to different entities. This need is strongest in decisions to chase all mass marketed scheme individuals and all EBA cases when compared to the compliance concessions given to most entities involved in research and development syndicates and service trusts.

The self-assessment system is here to stay, but most taxpayers have no hope of coping with the complexity by themselves. In my submission I note that taxpayers have a right to certainty, particularly if they have fully disclosed all their information to a tax agent and relied on that tax agent, as most do in the self-assessment system. A safe harbour should exist for taxpayers who have relied on a tax agent and fully disclosed their information even where tax avoidance is said to be involved—unless of course the tax agent introduced the idea to the taxpayer or colludes with the taxpayer.

The private binding ruling system is touted as the way that taxpayers can get a degree of certainty. The PBR system is indeed a key feature of self-assessment in Australia. However, in practice very few people seek a PBR, most relying on a trusted adviser other than the tax office. Since I lodged my submission, tax practitioners have expressed concern about difficulties in obtaining accurate, consistent and cost-effective ATO advice on technical issues, because the PBR process does not meet the needs of small practitioners and their clients. A working group has been set up with the tax office to address the problems.

The long-term viability of the tax agent industry and therefore the tax system itself is also of concern to me, and I note the commissioner's evidence to you that 24 per cent of tax agents will retire from the industry over the next three years. The community needs assurance that it will have cost-effective access to a sound body of tax agents into the future.

Finally, although the tax office has up to four years to reopen an assessment, it should be held accountable to make its technical decisions quickly and to communicate its intentions to taxpayers urgently. Inordinate tax office delays in this process create uncertainty and commercial dilemmas for taxpayers. My suggestion, at page 8 of my submission, is that the tax office be asked to consider a number of approaches to reduce taxpayer risks and increase certainty, particularly by doing more at the pre-lodgment and pre-issue stages of processing returns in areas it knows to have a high compliance risk or high potential for mistakes. Thank you for your attention; I am at your disposal.

CHAIR—Thank you very much. We might hear the opening statement from the Commonwealth Ombudsman before we move to some questions.

Prof. McMillan—I thank the members of the committee for the opportunity to make a submission and to appear in support of that submission. The specialist role that I hold as Taxation Ombudsman stems from a report of this committee in 1993, and so it is a pleasure to meet again with the committee on taxation matters.

The submission that my office has made is based upon the perspective that we gain from our work in the taxation area. Principally, that perspective is based upon handling individual complaints from taxpayers. We receive between 1,500 and 2,000 complaints a year across the full spectrum of taxation issues and from a full spectrum of taxpayers, including tax agents and members of parliament. The predominant number of complaints probably comes from either individual taxpayers or small business entities, but we do receive complaints across the board.

We also interact with the Taxation Office regularly in other ways. We are a part of consultative forums. We have had a close monitoring role in relation to the success of the Taxation Office complaint-handling system. We have made specialist reports arising from own motion investigations, the most recent on super co-contribution. The office does a separate annual report as Taxation Ombudsman just to draw attention to the specialist issues in this area.

I will just mention three themes that arise from our submission. The first theme is that we see many problems that the people have with the taxation system, yet our experience is that the Taxation Office, particularly in recent years, has been responsive to the fact that people do encounter difficulty in administering their affairs in a system of self-assessment where there are complex tax laws. It is our experience, based on individual complaint handling, that the Taxation Office has an open mind about exploring options, about examining whether there has been fault in an individual decision and about waiving or remitting charges or interest where it is clear that there has been innocence or misunderstanding by a person. It is prepared to examine alternatives such as the appointment of case officers to work through complex, entangled situations that people have got themselves into.

A second theme arising from our work and noted in the submission is that there is, nevertheless, inherent tension within the taxation system for reasons that will be familiar to the

members of this committee, including the complexity of the system, the high degree of automation in the system, self-assessment and the fact that at the end of most transactions people have with the Taxation Office is a decision that they pay more or less from their own financial reserves. So there is inherent tension within the system that will be a permanent feature of it.

Thirdly, however, our complaints-handling experience identifies some points of tension that can aggravate the inherent tension. Among the factors that can aggravate the inherent tension in the system, firstly, is people's reliance upon advice from the Taxation Office especially when they feel the advice is either slow in coming, difficult to obtain, confusing or misleading. On the other hand, the Taxation Office itself can find difficulty if it does not understand fully the factual background on which it is being asked to give advice. So the advisory function and the system of complexity are an inherent source of tension.

Secondly, delay in retrospective amendment of a person's taxation assessment is another point of tension. That arose most significantly, I suppose, in relation to the amendments some years later of people's taxation assessments and the imposition of penalties in relation to what have become known as the mass marketed taxation schemes. But, generally speaking, the tension is aggravated whenever there is a retrospective amendment of an assessment which was accepted initially and resulted in a refund, for example, to a person.

Thirdly, the imposition of penalties is another source of obvious tension that aggravates tension. A fourth source of tension is where adverse action is taken, particularly debt recovery against a person. Many of the complaints we receive are from people who are facing debt recovery and feel there is an administrative fault that lies behind it. A fifth source of tension is where people find communication confusing, particularly as the result of automation. We see instances, for example, where people receive multiple letters that may be at cross purposes or letters that are generated automatically that people feel do not address their individual affairs or are severely harsh or formal in their tone.

Finally, the increasing contact between members of the public and the taxation system is another point that can aggravate the inherent tension. Here, I refer to the fact that we now have a system in which people will often be in contact with the Taxation Office throughout the year and not just annually at taxation submission time. The reason for constant interaction can arise from a number of things—the GST and BAS statements, family tax benefit, the rulings of the Child Support Agency and the diversion of people's tax refunds, for example, to pay a child support debt, and schemes such as the super co-contribution.

All of those features which are now part of the government's legislative and policy framework can create a need for constant contact between people and the Taxation Office throughout the year. Particularly in our experience, if tension arises from one point of contact it can too easily lead to the development of an unsatisfactory relationship—and, in the worst case, a toxic relationship—between a person and a government agency that wrongly infects the entire relationship when in fact it may have stemmed from an incident that could be localised. I thank members of the committee for the opportunity to make a submission and to raise thematic points of that kind that arise from our complaints work.

CHAIR—Thank you very much. It has been a most useful start. We will move to questions of the Inspector-General and the Ombudsman.

Senator WATSON—Different treatments for different taxpayers is a little bit of a worry. On the other hand, I have some sympathy with the tax office. In certain circumstances where they are encountering aggressive lawyers supporting their clients I think some degree of firmness is certainly required. That is a problem I have had with ASIC at times. Sometimes I think they waited too long and allowed the lawyers time. It is just continuing the litigation process almost for the sake of continuing it. I can see the need for that degree of firmness.

On the other hand, there are taxpayers who are attempting to do the right thing. They may have made some honest mistakes or have not understood the law because of who they are, where they come from and where they are getting their advice from. I would like you to comment on that. I think we do need to distinguish between what I would call aggressive taxpayers who are using every possible loophole and technicality and those who are trying to do the right thing. If you are seeking a soft approach for everybody, I would have some difficulty in accepting that.

Mr Vos—I fully endorse your comments. Let me explain a bit about where I am coming from. I am not looking for an absolute here. What I am looking for is an issue of degree. Most of the comparable cases within a group of taxpayers will be on a continuum. At one end of the continuum there will be a number of taxpayers who have a legitimate case and have structured their arrangements in a way that ordinarily would stack up as being genuine tax planning arrangements. At the other extreme of the continuum are a number of cases that are absolute, sheer rort—either through the quantum involved or the way it is structured or established, they are nothing short of one step from fraud or evasion. In the middle is a whole mixture of both.

In part the reason for my suggestion here to immediately put the group into a single group and seek to uniformly treat them is to maintain the technical risk of having different decisions to similar cases. Also, it gives very clear direction to the staff within the tax office that this is the process that they are to follow without exception. Invariably, what will happen is that there will be, at the two extremes at least, inconsistent treatment. Maybe the person who should have been referred to the Director of Public Prosecutions for fraud is going to be let off as being a tax minimiser who is being a little bit aggressive and the guy at the other end with the legitimate case is getting grouped—not just by the tax office necessarily but by the community because of the way that person is being described in the press—in that group of tax rorters or tax cheats. So immediately you have a dilemma with those extremities.

The dilemma that I have in my role is that I am not looking at the 99 per cent of cases dealt with by the tax office—it might be 99.9 per cent of cases—that have been done exceedingly well, professionally and efficiently, but at those odd cases out on the edge that are inconsistent to the norm and are being treated, because of their systems, as being in that group of cases that should be treated as harshly as they may originally have been.

Senator WATSON—Are you suggesting that the different outcomes could be due to the fact that some people do their level best to get the matter into the courts because they might get a better outcome than by following the normal prescriptive routines?

Mr Vos—That has potential, but I imagine in the small business and the individual area, which has most of the taxpayers, the last thing that they would want to be doing is going to court. The amount of tax involved would not warrant taking that course of action anyway,

because the cost to go to court these days is quite expensive. It would only be for the very large cases that that would be a flow through expectation.

Senator WATSON—One of the advantages of the STS system is that the tax office can only go back two years. Do you have many complaints coming from taxpayers involved in the STS system? I know that in the past there have been some problems about tracing back depreciations and work requirements. It does have a lot of advantages, and I wonder whether some of those principles could be extended to other areas of taxation?

Mr Vos—The two years for the STS system only came in on 1 January this year, so it is really too early to tell. Even though the commissioner has four years of retrospective scope for most taxpayers—outside of STS taxpayers and individuals with straightforward affairs—in the review of aspects of self-assessment the message came loud and clear that most times when the tax office does a debit amendment, it will do it within two years anyway, but for the exceptional cases. They are usually the large business end and cases such as the mass marketed schemes, in which they were going back six years. A lot of the problems that arose in the nineties have potentially been fixed by the ROSA amendments, which have only recently been introduced. I reflected that in my submission.

I accept that in the individual area there are plenty of taxpayers who have complicated tax affairs and would not necessarily fall within the two-year remit. The two-year remit for STS cases does not apply where tax avoidance is said to be involved. My concern with tax avoidance is that it is a moving feast. I keep referring back to the decision of Lord Tomlin in the Duke of Westminster case in the House of Lords in 1936, where he said that it was up to all individuals to organise their affairs in such a way as to pay the least amount of tax. The House of Lords decision was nowhere near what the High Court or the Federal Court would now accept as legitimate tax planning.

Part IVA, the general anti-avoidance rule within the tax law, is very broad. The unfortunate thing—and this is a point that I think this committee needs to understand—is that a very large proportion of the tax avoidance cases and most of the employee benefit cases, as a classic case, were simply about timing issues. They were about taking advantage of a deduction now instead of over the next five years. That is the timeframe that we are looking at.

Most of the film schemes that were caught up in the mass marketed schemes involved purely timing issues. Unfortunately, the taking of a timing advantage is part of the tax avoidance remit of part IVA. So it is not as though these people are working to get out of the tax liability altogether; they are working at getting out of paying the tax in this year and paying it in a later year. They will have to pay the tax ultimately, in many cases.

Senator WATSON—Do you think that the tax promoters legislation will be effective in stopping some of these blatant mass marketed schemes?

Mr Vos—I have every expectation that it will have a very significant plank. The unfortunate thing that I have experienced in my three years in this job is that probably most of the taxpayers caught up in the EBA and the mass marketed schemes consequence had no real knowledge of what they were letting themselves in for. They relied in total trust on advisers. There is a real concern that advisers in the past have been too quick to half-sell an idea and not actually explain

to people that what they were getting into had a downside that could actually blow up in their face.

The people who went into these arrangements did so totally unwittingly, and that is something that the tax office accepts in the quietness of its own soul, but I think to the world it often comes out and says, 'I can only go the taxpayer; I can't always go the adviser. Therefore, my role is to administer the law by going the taxpayer.' The system that comes in after that is that the penalty is automatic: if part IVA is involved then a 50 per cent penalty is imposed by the law. Yes, it is remittable in whole or in part by the tax office, but it is up to the good graces of the tax office, and the interest is automatically imposable. The longer you wait for a debit amendment, the more the interest is going to be. Even though that has been mitigated by the shortfall interest penalty—

Senator WATSON—It is still severe, isn't it?

Mr Vos—It is still significant; it is still seven or eight per cent per annum, compound.

Senator WATSON—Do you think that should be limited to two years?

Mr Vos—The thrust of my submission is to suggest that the system is partly the tax law itself and partly the conduct of the tax office. I am suggesting that the tax office, where it is becoming aware or is aware that there is a spate of tax minimisation going on that could be suspect and have the potential to be caught by part IVA, should be putting out statements to that effect—that these things are going to be attacked—and/or act on the knowledge that they have, contemporaneous with the return being lodged. The fact that in many cases they have to go back four years leaves them with a complacency at times so that they say, 'I will spend a year or two working out what I'm going to do, a year to set up how I'm going to do it, and do it in the fourth year.'

Mrs BRONWYN BISHOP—Isn't there also the concept that if they let a few rip, they then have an idea of the critical mass, and when it becomes too popular, that is when they decide that it has to be an abuse?

Mr Vos—That is how it unfolded, as I believe it, in a number of the cases that we have been reviewing in my office. It is my view that it is incumbent on the tax office to have intelligence of what is going on in the community and then to make decisions. In a number of the reviews that I am working on at the moment—living-away-from-home allowance, R&D concessions—with respect to the R&D syndicates in some cases the tax office have been playing with that for 15 years. They have been dealing with the living-away-from-home allowance for over six years. With respect to the services trusts, they started looking at that in 1996, made an interim decision in 2005 and then a final decision in 2006.

They have moved a very long way from where they were in 1996 through to 2006, but 10 years is a totally unacceptable time, in my view, to be making a technical decision that is affecting taxpayers. If it is to change it for a prospective grab, fine; they can have as many years as they like. But then they come out and say: 'From today, or six months time, if people need to rearrange their affairs, that's the quantum we'll accept; beyond that is unacceptable conduct.' So that is where I am coming from.

Senator WATSON—Division 7A is a problem. Most people have run into problems in relation to division 7A before the tax office guideline process was initiated. And, when they finally gave some guidelines, the time signet was a little bit late. I am just concerned about people who are honest taxpayers, who made what now appears in hindsight to be a mistake through lack of adequate documentation—despite the fact that you are essentially dealing with one or two people but in a different capacity—and also the fact that some of these people, rather than declaring their position now that they know the problem, may be just putting their heads in the sand because of the consequences of the severe penalties that apply. Are you aware that some of these people are treated far more harshly than the most blatant tax evader?

Mr Vos—I have not come across that, but—

Senator WATSON—I think you soon will.

Dr EMERSON—I will go sequentially through the statement today and a few of the issues raised in your submission. The first is a statement that you made in response to Senator Watson, where you said in relation to mass marketing that people got caught up in such schemes with 'no real knowledge of what they were getting into'. You seemed to express a fair bit of sympathy for them. In reality, if someone signs up to a mass marketed scheme, surely they do know what they are getting into—that is, a tax minimisation or perhaps tax avoidance scheme. That is why they are doing it, presumably. Part IVA, as you know, deals with contrivances—that is, arrangements whose primary purpose is to avoid tax. How many naive people think they are getting into a mass marketed arrangement for purposes other than to minimise or perhaps avoid tax?

Mr Vos—The only thing that I can direct your thought to here is that we are dealing with very ordinary people in many cases. They were miners. They were retired school teachers. The way the offer was put to them was: 'Here is a tax assisted investment with very high return that will help reduce your tax.' Yes, it is to reduce tax.

Dr EMERSON—Yes.

Mr Vos—I guess I have a dilemma, on a continuum, of thinking in the first instance that, when a business gets to 15 June each year, the decision can be made: 'Do I buy stationery now or after 1 July? If I buy the stationery now—or a new car or whatever it might be—I am going to get a part deduction or a full deduction in that year.' There was an ability to prepay expenses and get a deduction in the current year, but then the specific anti-avoidance provision was brought in, limited to 13 months. But you can still legitimately reduce your tax by a traditional means.

An accountant might come to you and say, if you have a very high income in your business: 'Don't establish it as a sole trader because you'll be paying an average tax rate of about 45c in the dollar; establish it as a company. You'll only pay 30c in the dollar, and then when you distribute the profits a year or so later you can selectively distribute it, maybe to a few of your kids, to your spouse and to others and minimise the impact of the liability—assuming that they're shareholders or they're providing services.' But, again, that is reducing your tax.

I think these decisions have to be considered in the light of that type of advice: 'If you do it this way, your tax liability will be reduced.' It was never promoted to them, as I understand it, as being, 'Do it this way; this is a good way of rorting the system or avoiding the tax.' It was

expected that these people were putting money into agricultural investments that were going to be of benefit to the community. In fact, you have some parts of government that are saying, 'Let's encourage forestry arrangements,' 'Let's encourage the development of more wineries,' 'Let's grow more grapes,' and, 'Let's have more production of nuts,' and things like that.

So these people, I suggest to you, were not actually going in with a full knowledge of what they were doing. Yes, they knew they were going to be reducing their tax liability, but it was a tax effective investment where the tax system was going to subsidise that investment. That is the way that the thing was sold to them.

Dr EMERSON—I understand that, but it seems to me that, when a proposition is put to a retired school teacher or a miner, for example, that they invest in something about which they have no life experience, such as an agricultural scheme—they are not farmers, after all—and that as a consequence of that there will be a guaranteed large return within a year, wouldn't people say, 'That sounds too good to be true,' and, 'Why isn't everyone else into this'? Let's make up a number: 'If you do this, you will get a guaranteed 30 per cent return.' If there were guaranteed 30 per cent returns on investment, why would you go to the stock market? Why would you put money in a bank account? You would say, 'This is where all the nation's savings should go.' It seems to involve a level of naivety.

CHAIR—To go to the point Dr Emerson is making, whilst there would be a certain number of people who have gone into these schemes for the reasons you said, there would equally—though you will not see them in the submissions—be a certain number of people who were offered these schemes who did not go into them for those very reasons. Leaving tax aside for a second, can it be compared to someone offering an unrealistic return on an investment?

Dr EMERSON—If it sounds too good to be true, it probably is. I think that is the rule that people should use.

Mr Vos—And that is the message now that the tax office is putting out. It is almost without exception the case that all of the agricultural tax-effective investments that are still going on have product rulings from the tax office blessing them. The sorts of things that were in existence back in the nineties do not exist now—the non-recourse loans, the accelerated use of the funds. The mischief that was occurring there was that the benefits that were flowing to the promoters were the tax consequence that was going to the individual, and that was flowing through in non-recourse loans that were just collapsing. So it was the nature of how they were packaged that was wrong, not the underlying investment.

Dr EMERSON—I understand.

Mr Vos—I have to be very careful here because I am not sitting in front of this committee saying that those 40,000 people involved in those arrangements were lilywhite; I am just making the observation that many of them had no understanding of the complexity of the issues that are the underlying principles within the arrangements, because the tax law in Australia is complex. I am just making the point that they accept without question, if an adviser tells them that there is a counsel's opinion that is being gotten, it must be sacrosanct and, if they get a second opinion from a firm of accountants or lawyers, that must bless it even more. I am just making the observation that I do not think that that can be compared to when a person decides to put 50, 60

or 70 per cent of the proceeds of their business into their pocket and not put it through their books and pay tax on it. Tax avoidance and tax evasion are totally different scenarios. Tax avoidance is a moving feast that is far from being black and white. Tax evasion is a very black and white exercise and is absolutely abhorrent.

Dr EMERSON—It seems to me, though, that there are very high financial returns on naivety if you say: 'Gee, I didn't really know. In truth, I didn't really want to know. It sounded terrific and I got the guaranteed return. No, I didn't look into it. I'm not really one of these financial whizzes; I just signed up.' That goes to the next question. You were talking about the range of people caught in mass-marketed schemes from shades of white through to black, if you like. How could the tax office enter the minds of people and say, '15,000 were naive, 5,000 were a little bit more willing and the others were into every rort that they could get into'? Isn't it the right mechanism that the tax office can remit the penalty tax and interest charges in circumstances where they do make a judgment rather than having a rule which says, as I think you are saying, penalty tax and interest are remittable for the unwitting and the tax office should be putting out statements? I agree that the tax office should put out statements where it can, and I think it does, actually. It alerts people and says, 'Hey, be very careful about these schemes or we'll have a crack at you.' But I do not know that there is a better system than the tax office itself having the discretion to remit these penalties and charges.

Mr Vos—I am putting forward a proposition that the tax office cannot just abrogate its responsibilities as an administrator; it has to be in the system and engaged in the system. I think it is fair to say, if you make the comparison with everyday life, that we have many rules around us that can only be described as protecting ourselves from our own stupidity. We have speeding fines, we have—

Dr EMERSON—Seatbelt requirements.

Mr Vos—seatbelt requirements and we have excess alcohol issues. There are a whole heap of rules that are imposed on us as a community because governments seek to protect us, as I say, from our own stupidity. In this case I am only making an observation that it would be practical for the tax office, when they know that these arrangements are occurring, to attack—if you want to use that word—them at that time, not two or three years later. That is the first point.

Dr EMERSON—I agree with that.

Mr Vos—The second point is to process the group that they might have into various subcategories on their degree of culpability—if you want to use that word—and separate the genuine cases. In other words, look at each case on its merits and take into account the individual circumstances of each case.

Unfortunately, there was a point with the mass-marketed schemes and the EBAs where the tax office did not even meet with any of these taxpayers; they just got blanket letters. They were treated as though they were guilty, so pay up. The only process that the tax office was working towards was to get that deed of settlement out of the taxpayers so that it could then unwind the penalties, unwind the interest and, in the case of the EBAs—the trusts ones, at least; one-third of the total—to withdraw the FBT assessments. I find it absolutely difficult to comprehend that you can have assessments out there that you do not intend to act on and have a very clear intention of

withdrawing once you get the taxpayer to agree to withdraw his or her rights to dispute in the courts. Once that occurs, all of the leverage that the tax office has against the taxpayer is taken away. The penalties are remitted, the interest is reduced or remitted and the multiple assessments, in the case of the EBAs, are withdrawn. I think it is that concept that I just do not want to keep seeing recur. Yes, the tax office needs to be tough on cases where it should be tough, but I am just suggesting that it is not appropriate conduct to put a large group of taxpayers into one bucket and treat them exactly the same.

Dr EMERSON—Mr Vos, you talked about it being a timing issue with a lot of disputed tax assessments. But, just using the example of employee benefit arrangements, that timing issue is up to 10 years. I understand your case of buying up some more stationery on 15 June to get a deduction in that tax year rather than in the subsequent tax year, but these are not one-year timing issues; a lot of them are—

Mr Vos—No, some of them could be longer than 10 years, they could be much more, but—

Dr EMERSON—Isn't the opportunity cost of that money to the Australian taxpayer pretty high when you have a 10-year deferral available to you? I do not mean to be too critical, but it is almost as if you are saying, 'It is just a timing issue.' If it is more than, say, a year, it seems to me it is a lot more than just a timing issue, because the value of $100 in 10 years time will be much lower than the present value of $100.

Mr Vos—That is fine. Again, I just want it on the public record that they are timing issues. Some of them are only three to five years, some of them are 10 years, but it is the question of the community understanding that that is what tax avoidance means to many. I just wanted that on the record, because I do not think it has been fully understood up until now that often these are only timing issues. I do not disagree with your proposition. I am not taking a moral stand here. I just want this committee—and it is the purpose of my being here today—to have the full facts in front of it as it is making its deliberations. You can then accept that a one-year delay is improper and should be attacked in a particular way. Again, I am just using the consistent approach of saying, 'Let it not be that the tax office sits on something like this for three or four years and then find out that, when the amended assessment goes out with the penalty and the interest, we are talking about double the tax that it would otherwise have been if it had been attacked earlier.'

Dr EMERSON—I understand.

Mr Vos—That is the real thrust of what I am talking about in that context. It is not to suggest that these things are right; it is not to suggest that the conduct of these people is lilywhite. There are a lot of extenuating circumstances here that I think need to be taken into account. One of them is the conduct of tax agents, another one is the conduct of advisers and the third one is the conduct of the tax office. That is the real thrust of my message today.

Dr EMERSON—My final question, at least in this round, is in relation to small businesses. There has been some publicity recently about the number of small businesses that have effectively been wound up as a result of the tax office pursuing tax that was not duly paid. I think it is a fairly substantial number, running into the thousands. Do you have any views on the conduct of the tax office in relation to the pursuit of those small businesses?

Mr Vos—Yes. We did a report—and it is one of our published reports—on small business debt. We said in that that the claim that was being made that the tax office was being too tough was incorrect; it was being too lenient. Having said that, the focus of our recommendations was that the tax office needs to identify those cases where small business is rorting the system and building up debt and has no capacity to pay it—and has no intention to pay it. It needs to wind them up earlier, if necessary, because the longer that they are kept going the bigger the debt is not only to the community in their tax liability but, more likely, to their suppliers. Where businesses are totally uneconomic, it becomes an issue for the government to determine whether they are going to underwrite them, through the tax system, by allowing the tax office to delay the process of collecting. My concern is that, where there is a legitimate business and there is a short-term inability to pay, the tax office should engage—and I believe is, with many—to work out a system of getting an extension of time to pay the tax.

Dr EMERSON—There would be a strong competitive advantage on the part of the former category if you had one small business with no intention of paying tax, another small business paying tax and the first small business were allowed to continue. It is not your statutory responsibility, but I suppose that is another consideration.

Mr Vos—We raise that in our report. I had the horizontal equity issue to look at. I thought that if two businesses out of three are self-funding their tax or borrowing money to pay their tax it would be unfair to allow the third to operate in competition. It is not as though these small businesses are buying BMWs and overseas trips. They are actually putting the money back into growing their business, but if they are not paying their tax they can grow it far quicker than the other two businesses—if we are doing a comparison of three—who are legitimately paying their tax as they go. There was a side issue in our submission to say that a lot of small businesses just are not trained in how to manage their cash flows and to accept that they have to put their money away from the beginning to pay their quarterly tax liabilities when their business activity statements are due.

CHAIR—For the benefit of members of the committee and everyone else present, we had intended to run this evidence through until about 11 o'clock. I will just flag that it is my intention to push on a bit past that because it is important evidence we are hearing and I do not want anyone to feel that their questioning is being curtailed. If people are happy to, we can potentially go on for 45 minutes to an hour from now. I do not want members and senators to be rushed. I want to raise one question, taking a step back from the issues you have been talking about. My question goes to the issue of people being unwittingly caught in these schemes on the advice of advisers. At a broader, more generic level, is there more in a communications sense that the tax office could be doing to overcome what seems to be a problem that has arisen where, if people are using tax agents, they tend to operate on the assumption that they do not need to check that everything is completely aboveboard?

It is a bit of a double-edged issue sometimes because, of course, the ATO has its own program with tax agents. I am not for a minute suggesting that tax agents do not do a good job. But where it obviously becomes a problem is where there is advice being given that pushes the boundaries. It is in that sequence of events where members of the public would think, 'If it is being recommended to me it must be right, mustn't it?'

Mr Vos—The thrust of where you are coming from leads me to make the following points. The first point is that the tax office is doing what I believe is a very good job now at communicating to taxpayers and tax agents areas they are likely to be interested in. On that score, I do not suppose there are too many taxpayers in Australia who go to the tax office site every day, look at it and keep abreast of all of the communications coming out of the tax office. I am battling to keep up with it.

The second point is that tax agents are the central point in the system. They lodge 75 per cent of personal tax returns and 95 per cent of business tax returns. Without tax agents the whole system crumbles. I think it is fair to say that one could assume that there has been a practice within the tax office that if a tax agent has put the return in then it is acceptable. Unfortunately, now, if you look at the commissioner's compliance program, you will see that I think last year about 600 tax agents were being looked at for special circumstances. They may be conducting criminal or grossly negligent activity, putting excessive deductions in their clients' returns and/or doing things that they should not be doing.

I do not know whether that 600 is representative. If we look at it, there are I think 9,000 registered tax agents lodging more than 100 returns a year. There are 20,000 registered tax agents, but many of them are either retired and do not lodge returns or subsumed into another registration because they are a partner of or an employee of another entity. If the tax office is targeting 600 each year, that is a very high proportion of the base.

I included in the submission a very significant point about the need to wait for the regulation of tax agents legislation that I imagine is due to come in soon. The government announced in the last budget that it has allocated something like $50 million over the next five years for that program. The government made an announcement in 1998 by the then Assistant Treasurer and also in the budget on 9 May or whenever it was this year that that program is about to go ahead.

My view is that the tax office needs to very cleverly and clearly regularly monitor conduct of tax agents because if they are running amok then we have real problems. That is because they are not running amok on one return; they are running amok on 500 or 1,000 or more.

Prof. McMillan—Can I comment generally on the issue of education and communication strategies since it is an issue that arises frequently in our work, not just in relation to the Taxation Office but in relation to all government agencies, particularly those dealing with large numbers of members of the public and where there are complex laws. Our general experience is that you cannot criticise Commonwealth agencies for not engaging in public education and communication strategies. However, you can remind them that their communication is not always being understood by the audience to whom it is directed and is not meeting its purpose. Consequently, government agencies need to be monitoring constantly what people are hearing.

There are some simple examples. One of the reports that we recently did on super co-contribution in the taxation area turned up the fact that the major issue was one of communication, stemming from complaints people often made that, 'Well, I didn't know.' I think, in every instance we investigated, the material was there. There was a document, a statement or an announcement that covered the issue. But it clearly had not got across to or been understood by the person. That is generally the experience in all of our other areas—that, on further analysis, there is something there, but it clearly has not got across to people. On the other

hand, we see instances where the *TaxPack*, which is a great idea, can then be overloaded, and that leads to complaints of a different kind—that certainly the information was there but it was surrounded by so much other information that it became impenetrable and hard to detect.

I think those points are simply a reminder to government agencies that communication strategies are something that have to be tested and monitored. One of the best ways of testing and monitoring it is just having an internal complaints line and being engaged with external oversight bodies and professional organisations to monitor what message is being heard by them.

Mrs BRONWYN BISHOP—I want to couch my initial questions against the background of the statement that the new commissioner made when he first took over as commissioner. He said it really did not matter if taxpayers understood tax laws at all because they all used tax agents. But the whole underlying ethos of the tax act is that the taxpayer remains culpable for any errors made by the tax agent, at first instance, even though he may have an action against the agent.

Mr Vos—You are correct: that is the process as it currently stands. I think the context in which maybe we need to think going forward is that the government's planned policy, if one takes it from the 1998 announcement by the then Assistant Treasurer, Senator Kemp, and the current minister—

Mrs BRONWYN BISHOP—We've been through a few since then.

Mr Vos—Yes, we have had quite a few. But with respect to the proposed changes that will be made, where a taxpayer effectively provides a full disclosure to a tax agent and the tax agent has acted irresponsibly in preparing the return, there will be a penalty imposed on the tax agent—I will come back to that—but not on the taxpayer. The penalty imposed on the tax agent, as I understand it, is more in the nature—

Mrs BRONWYN BISHOP—But it is not law yet. You haven't seen it.

Mr Vos—We haven't even got draft legislation.

Mrs BRONWYN BISHOP—We do not have draft legislation. We have a statement that was made, and we have had three additional assistant treasurers since that time, so I am not holding my breath.

Mr Vos—I think it is a very trite proposition that average taxpayers can determine their tax liability if they have, for instance, a sale of shares and they have a capital gains tax consequence or they have just sold a rental property with a capital gains tax consequence. The issues there are so complex that you need to go to a specialist—not just any suburban tax agent but a specialist tax agent who can deal with some of those issues. Not all tax agents are going to understand all of the propositions that will affect some taxpayers.

Mrs BRONWYN BISHOP—I want to concentrate in this part of my questioning on the fact that we have established that the complexity of the law is such that people need tax agents. You have said that without tax agents the whole system would collapse. You point out in your submission that many tax agents are leaving the system because it is far too complex. You point out, and I think the commissioner himself said, that 17 per cent of them are going to retire. The

base is diminishing yet the degree of complexity is added to daily and there is no attempt to reduce it. When you go on to say in your submission that the PAYG system now results in the consistent over-collection of tax, could you tell us how much that is? What figure could we put on that?

Mr Vos—The number we have in the submission is $15 billion per annum. I think that is last year's number; it might be this year's number. It has been growing and, I think in the evidence that was given at the June hearing of this inquiry, it was bandied around that the number has gone from about $9 billion 10 years ago to something like $15 billion now.

Mrs BRONWYN BISHOP—That is $15 billion that the government has every year for free, because it pays no interest on those overpayments, does it?

Mr Vos—Correct.

Mrs BRONWYN BISHOP—Against that we have a very harsh penalty regime. For instance, if a taxpayer, who might be a sole-trading small business person, is five seconds late with their quarterly payments, they are immediately hit with a GIC. Is that right?

Mr Vos—Five seconds?

Mrs BRONWYN BISHOP—Say five minutes.

Mr Vos—No, not quite.

CHAIR—It would have to be 24 hours.

Mr Vos—That is right. To take your point, if you pay tax late there is interest imposed, yes.

Mrs BRONWYN BISHOP—The GIC, which is at 12.6 per cent as we speak.

Mr Vos—Correct.

Mrs BRONWYN BISHOP—And yet the Treasury has the effrontery to say that, contrary to the policy intent, the ROSA review identified the willingness of many taxpayers to incur the GIC rather than borrow to clear tax debts. Treasury speculates that the GIC may constitute a 'soft, application-free source of finance'. In the inquiry you did of the interaction of self-assessment and the application of the penalty and GIC regime, did you see any evidence that it is a soft source of money for taxpayers?

Mr Vos—Actually, in that report we used the phrase 'the punitive type impact of the interest' on late—to be honest, we did not actually focus on the late payment of tax; we focused on the late raising of an assessment and the equivalent of what was then GIC and is now SIC.

Mrs BRONWYN BISHOP—They are still both uplift factors.

Mr Vos—Correct, but, if you know you have a liability to pay the tax, you pay it and get no interest or, if you cannot pay it, you either borrow the money from a bank or suffer the—

Mrs BRONWYN BISHOP—Once the GIC regime was in place, many small business people could cope with having to repay the primary reassessment—even though they do not think it is just and they argue that they should not be up for it anyway—but they have no money to fight it. It is the application of the penalty and the GIC rate that crucifies them.

Mr Vos—Correct.

Mrs BRONWYN BISHOP—The tax office will then move to bankrupt them and will be the only creditor. It is happening again and again. The crucial thing that hits them every time is the GIC. I want to read from the submission of Don Randall. He has dealt with the problems of some of his constituents, but this is a general point that I think is very pertinent:

It is apparent from the penalty structure that taxpayers can be adequately penalised when appropriate. The inequity arises in the shortfall and general interest charge (GIC) provisions. In both the shortfall and GIC provisions the applicable rate includes an uplift factor, which is clearly a penalty component. When the shortfall and GIC amounts are calculated they are applied to the primary tax as well as the penalty. In other words, penalties are imposed on penalties. For example a taxpayer has a primary tax shortfall of $100,000. The penalty applied is 50%. Total tax plus penalty is thus $150,000. Shortfall interest at 8.63% over two years on $150,000 amounts to a further $28,255. As the uplift factor in the SIC is 4%, the penalty component of the SIC is $13,703. This means that if the ATO takes two years to make the amendments—

which is quite frequent—

the taxpayer penalty is effectively increased by 14% and the total penalty imposed is now 64%. Lets say this taxpayer appeals the matter and it takes a further two years—

not uncommon—

during which GIC—

the so-called soft option, according to the Treasury—

is applied at 12.63%. The GIC amount is $51,215 and the uplift or penalty component is $33,921, which is a further 34% of the original tax shortfall. The total penalty is now 98%. The total tax payable in this example—

then rises from $100,000 to—

... $229,470.

That example is repeated again and again and again. Whether the primary rate starts out at $18,000—and I have constituents who come to me about such amounts—or whether it is $15,000, it crucifies them and they cannot do it. Is that fair and reasonable? Does that meet the fairness test of what the tax office is supposed to do?

Mr Vos—That is what the law says. That is what governments, now and in previous terms, have introduced. That is the dynamic. That example gave reference to the time from the raising of the amended assessment to the time it is heard in the court—those two years.

Mrs BRONWYN BISHOP—Even allowing for abeyance, it is simple. They could go back four years and get half a million.

Mr Vos—Let's say they have gone back those four years and raised an assessment, we are then talking about the four years of SIC. That is one issue. At that point in time, the assessment is due and payable. Most taxpayers pay the tax that is in dispute at that time, or enter into an agreement with the tax office to pay half. If they do not have the ability to do that , it is different—and I know where you are coming from. In the case of the EBAs, most of them had assessments that the tax office had raised that multiplied the total original tax by six with penalties, interest and multiple assessments. Then those assessments were collapsed—

Mrs BRONWYN BISHOP—They did more than that.

Mr Vos—and they remitted the penalty and—

Mrs BRONWYN BISHOP—The commissioner—and I draw attention to your opening statement today with regard to Essenbourne—in that case insisted for years on saying that the amended assessment was taxed at two taxing points. It was taxed at the points, firstly, where the tax office said, 'We will deny you the deduction and we will apply this penalty and this interest,' and then, secondly, where it said, 'But if you beat us on the contribution point, we will go you for FBT.'

Mr Vos—Correct.

Mrs BRONWYN BISHOP—Essenbourne said, 'You can't do that.'

Mr Vos—Correct.

Mrs BRONWYN BISHOP—And it perpetuated—

Mr Vos—And so have five subsequent court cases.

Mrs BRONWYN BISHOP—He continued to do that for years, to the extent that in one of those particular cases that Mr Randall brought along the original debt was $1 million and the outstanding debt is now $10 million. Interestingly, when we had the tax office before us two or three weeks ago, I asked the question: are you still issuing assessments at both taxing points? I was told they now have desisted from doing that.

Mr Vos—Correct.

Mrs BRONWYN BISHOP—How long does it take to make the tax office follow what the courts say is the law instead of saying, 'We are the tax office and we will determine the law'?

Mr Vos—I purposefully included in my opening statement and in my submission a reference to Essenbourne and the concern that exists in my mind that at times the tax office blurs its role of administrator versus policy maintainer or protector. At the end of the day, as I see it, once a decision has been made by the courts and is found to be right, the tax office is bound, as we are all bound, by the precedent.

Mrs BRONWYN BISHOP—But the tax commissioner will not do it.

Mr Vos—The unfortunate thing with Essenbourne was that he then went on to another case—Walston. The late Justice Hill said that the first decision was right. He said: 'We have to have comity amongst us as judges. It was right.' It is fascinating to find that, in the last month—and I have quoted it in my opening statement—the commissioner has had a decision in a so-called test case—Indooroopilly. The judge there said: 'Hang on, it has already been decided four times. What are you asking me for?' Yesterday as I was preparing for today I found that another decision came out on 21 July—last week. It was the same issue. The courts have found for the fifth time that Essenbourne is right.

My job is not to look at the technical side of these things. But there is a point at which one has to wonder what is going on in that tax office to allow this conduct to perpetuate where individual taxpayers are at risk of the consequential penalty in interest and also the primary tax.

Mrs BRONWYN BISHOP—That is right.

Mr Vos—There is an issue here. The SIC was introduced by the parliament in the last 12 months.

Mrs BRONWYN BISHOP—Yes, as part of ROSA. It is 8.34 per cent. Is that right or wrong?

Mr Vos—My argument to it is that the tax office can mitigate against that impost in the first instance by acting in advance of the return being lodged, so that you do not ever have to consider SIC, or doing it within the first six months after, where the SIC would be negligible. My point keeps on coming up. If you let it blow out to four years, it will always double the primary tax.

Mrs BRONWYN BISHOP—That is exactly why that point about two years, four years and part IVA is so important. I have asked the tax office—and they will give you no answer—where is their ruling or definitional policy of what is simple and what is complex, and what issues are going to determine whether they go with IVA. It simply leaves carte blanche and makes a joke of the legislation.

Mr Vos—We are singing from the same hymn sheet but with different perspectives on where we finish up. In my role as Inspector-General I have to accept that when parliament sets the law the only prerogative that I have is if there is a systemic issue in tax administration for me to raise the underlying little 'P' policy that is associated with it. But the big 'P' policy is not in my remit. It is an issue for the board of tax at best, but not for me.

Mrs BRONWYN BISHOP—Absolutely, but the principle based system of grafting that we are now indulging in makes the problem worse, it seems to me.

Mr Vos—I will let that one go through to the keeper if you do not mind.

Senator MURRAY—Just for clarification, Mr Vos: you said that you cannot raise big 'P' policy issues with the government. There is nothing to stop you raising it with the Board of Taxation, though, is there?

Mr Vos—No, but the Board of Taxation are only given a remit to look at particular issues on the request of the government. They have no power, no authority, to look at issues on their own notion.

Senator MURRAY—But you can raise big 'P' policy issues with the Board of Taxation.

CHAIR—Only if they are looking at a particular issue. Is that your point?

Mr Vos—Yes. I can raise issues with them, but what is the point in talking to somebody about something unless you know that they are interested in taking up the matter or can take up the matter.

Mrs BRONWYN BISHOP—Firstly, I think it is important to put on the record that ROSA does not cover GST payments. That is a very difficult issue for people who are caught up in decisions that the commissioner is making that go back forever. I think there is a need for ROSA to cover GST. I do not know if you have looked at it, but I would be obliged if you would. My second point is: did you or anyone else at any time make an assessment of what savings to the government have been made by introducing self-assessment? Has anyone put a figure on it?

Mr Vos—I think in the last JCPAA hearing of 1993 or thereabouts there was evidence given that the move to self-assessment would reduce the need for something like 6,000 or 8,000 staff to do the assessment process on an annual basis. The short answer, though, is that I doubt very much whether any study has been done on that score. I often have the comical quip that taxpayers have the responsibility for meeting all of their tax liability, lodging their returns, lodging their BAS and paying their tax, so what do the 22,000 in the tax office do? In reality they have a number of enforcement roles, debt collection roles and inquiry roles, but I imagine there is a separate process for parliament and others to continue to monitor just what the tax office is currently doing.

Senator WATSON—They have reduced their staff numbers.

Mr Vos—They reduced their staff numbers during the 1990s, following the introduction of self-assessment, to meet the world benchmark standards for cost of collections of tax.

Mrs BRONWYN BISHOP—And after we got rid of the Boucher agreement.

Mr Vos—It is very interesting and worth putting on the table that, in most countries that have embraced self-assessment, most individuals are not required to lodge a return. We, like the States, have a process whereby all individuals who have a taxable liability or who have had PAYG withheld are required to lodge, but in a very large number of the countries that have self-assessment—and it is in the majority—there is no requirement for individuals to lodge a return. So there are a number of issues regarding the role and responsibility of the tax office and what can be done, but I am not espousing today that that is something that should happen in Australia.

Mrs BRONWYN BISHOP—It would certainly be worth looking at.

Mr Vos—It is something that needs to be examined in the whole concept of what self-assessment savings contribute to the cost of administration of tax.

Mrs BRONWYN BISHOP—With regard to collections—and I have tried to find this figure; I have asked the tax office for it and to my knowledge it has not been given to us—what amount of revenue each year is collected from the penalty regime?

Mr Vos—I would not know. I know you have asked them that, and I would be interested to see that myself.

Mrs BRONWYN BISHOP—I have one last question, and it relates to the work that the 22,000 tax office employees do. They have a reward system. They get a bonus payment which seems to be connected to the amount of extra revenue they get in by going over somebody's tax return, finding that they owe some money and applying some penalties and interest to them. So if a little unit within the tax office does well and reaps in a lot more money then the people who work there get paid extra. That whole principle is offensive to me. It smells of the old French tax farming, where collectors were paid on the basis of how much they got in.

Mr Vos—I cannot speak to that. I do a benchmarking of the salaries paid to my staff against those that are imposed within the tax office and within Treasury. I understand the bonus system that you talk about, but my understanding is that it is not as directly referable as you are pointing out to me today. If I understand it correctly, from the evidence that was given by the tax office, the bonuses are only given to EL2s and SES staff. They are more closely aligned to the focus of the role of that individual in amongst the group that he or she is employed in and the performance of the tax office as a whole.

Mrs BRONWYN BISHOP—I think that is something that could be quite legitimately examined.

Mr Vos—The other point to make is that from their annual report I think the most that is ever involved in the so-called bonuses is either five, 10 or 15 per cent. I do not think anyone gets 15 per cent. Some people get 10 per cent, but most get five.

Mrs BRONWYN BISHOP—I do not care if it is two.

CHAIR—It might be a question to pursue another day. Before we move on, I know the Ombudsman was going to add to some comments, and I have a generic question.

Prof. McMillan—On the last point, my office has had a couple of complaints that we have investigated about decisions being referable to bonus systems. It is probably best if I ask Mr Browne to comment on it.

Mr Browne—We have received complaints in the past about this, but not very many. We have investigated some of those complaints, and the evidence we have seen would not suggest that there is any direct connection.

Mrs BRONWYN BISHOP—Is there an indirect connection?

Mr Browne—The kinds of bonus schemes that exist essentially are the same that exist across most government agencies in terms of—

Mrs BRONWYN BISHOP—But they are not the tax office. Is there an indirect connection?

Mr Browne—No. The connection is really to do with their broader objectives within those areas. So within the debt collection areas it is really just to do with the effectiveness and efficiency.

Mrs BRONWYN BISHOP—No, it is not the debt collection area I am talking about.

Mr Browne—It would be the same for the assessment areas and so forth. Essentially, it is the same kind of bonus system that would work across any level of government in terms of performance against business plans and the like.

Mrs BRONWYN BISHOP—I am sorry—the tax office is special. They are taking your money compulsorily.

CHAIR—But you are saying that, on the cases you have investigated, there is no—

Mr Browne—The cases we have seen—

CHAIR—And that is your evidence.

Mr Browne—Yes.

CHAIR—On the point that was made with respect to the Board of Taxation—and I think it probably equally applies to you as an ombudsman—the question, obviously on behalf of the committee, is whether there should be a change so you can have a direct line of inquiry or power a submission straight through to overcome the restriction that you articulated, which is—

Mr Vos—Let me make the observation here that I meet with the board of tax at least twice a year, and I meet regularly with the Ombudsman and the Ombudsman's office, either directly or through my staff. In my case, I also regularly meet with the ANAO and the ANAO's office. I am not shying away from the argument that there would be a direct avenue for me to approach the government directly. But there is no point in making an observation today regarding the sorts of things that might be in my mind to address a government of the day about.

CHAIR—No-one is suggesting you do not all meet regularly, all get on well and discuss things, but if you are working in the area the whole time—and the Ombudsman has a slightly broader remit—and you come across an area of policy where you could make a formal suggestion, would it be better to be able to do that rather than—

Mr Vos—I am sure there would be a number of ways that that could be done. The other group that I meet with of course is Treasury. I am in the Treasury portfolio and, although I am independent of Treasury, the tax office and other parts of Treasury, I can take the matter up with Treasury and expect that they will take it up with the appropriate arm of government. I was not shying away from the issue. It was just that there has not been any need to raise it so far. But, to the extent that there is an issue, I would be interested in hearing from Mrs Bishop and taking it forward if necessary.

Mrs BRONWYN BISHOP—With the observation you have made about the blurring between tax policy and tax administration, which often manifests itself in a ruling, it has long been my contention that if that is prevented the real function of law making would be returned to the legislature. If, when the commissioner made a public ruling, it was not by making a speech, declaration or whatever forms he has put in place now but was done by way of regulation and was subject to tabling and disallowance in both houses of parliament, it would mean that the legislature would again be making tax law.

Mr Vos—That is a prospect for government to contemplate. At the present time, I am merely focusing on the prospect that in some cases there is a tendency, in very rare circumstances, for the tax office to seem to be propping up incomplete laws or a statute that is at odds with the original policy intent. It is fair to say that it was part of their remit until 2002, when tax policy was moved across to Treasury, but I think there is a tendency at times for them to feel as though they own this tax and need to support the policy, even though in strict terms they should be at least announcing to the world that it is a matter for Treasury to take up with the government and to get the law changed.

Senator HUMPHRIES—Mr Vos, I want to explore your comment in your submission about tax agents in certain circumstances being effectively a proxy for the commissioner. I assume that is in the context of the announcement by the Assistant Treasurer in 1998 about the protections available under self-assessment in certain circumstances. I suppose I have a certain disquiet about the dangers that might generate. I also assume that, as an extension of that, you proposed in your evidence earlier that the taxpayer should not be penalised when they are relying on the tax agent's advice, unless there is collusion. What would the effect of that proposition be? If that was the suspicion of the tax office, for example, in certain circumstances, would there be an onus on the commissioner to prove collusion in those circumstances?

Mr Vos—I am one of the few people in this room who remember the time before self-assessment. I was an assessor in the tax office between 1966 and 1968 and remember the process of lodging returns and what took place prior to self-assessment coming in. There is an impression in the community that the tax office was in full knowledge of all of the issues of a taxpayer at the time of raising an assessment. Of course the tax office was not, but they had a pile of information in front of them and, with the knowledge of the tax law, could make an informed judgment that invariably was done prior to the raising of the assessment.

What I am trying to say in an analogous sense is that the registered tax agent knows tax, or should know tax, otherwise they should not be a registered tax agent. They have to know tax. They also have to know from their own experience what the tax office accepts and does not accept—what is acceptable process and conduct and what is not. I am drawing a very long bow comparison that the role of a tax agent could be compared to that pre-issue check that was done by the tax office by those assessors prior to 1986 for individuals and 1989 for companies and super funds.

I guess in that context I am presenting a proposition that has a lot of strings attached. The first thing you would need to do is police the quality of the tax agents. The first thing that might eventuate in this controlling and regulation of tax agents is that half of them might be delisted. Half of them might be required to go and do more training. I do not know. I really do not have any expression of view on that proposition. It could well be—and I hope it is—that 100 per cent

of registered tax agents know the law, know what the tax office requires of them in fulfilling their responsibility and do it honestly, fairly and correctly.

It is in that context that, assuming that that is intact, the so-called safe harbour that is being proffered is a step towards the improvement of the tax system. It is a long way from the 1990 announcement by the then government that if a tax agent prepared a return and got it wrong then the financial penalty that would otherwise have been imposed on the taxpayer would be imposed on the tax agent. I imagine that, from 1990 to 1993, when the JCPAA met there was a lot of scurrying by the accounting profession to protect the notion of: who would want to be a tax agent if, when they got something wrong, they would get the financial penalty that otherwise would have gone onto the taxpayer?

Mrs BRONWYN BISHOP—You can make them sign an indemnity.

Mr Vos—But in this case this was going to be the policy of the then government. I guess in this situation it is an idea that I am putting forward to this committee merely to consider. I am not putting it as a recommendation; I am putting it forward as a suggestion. You can as a committee make the judgment that tax agents are no more to be trusted than taxpayers and we should give them no concession.

Senator HUMPHRIES—I suppose it is a question of: who does the tax agent work for—the taxpayer or the tax commissioner? I hope he works for me when I go to see him.

Mr Vos—It is a classic issue that needs to be dealt with, because invariably there are certain responsibilities under the legislation that they must adhere to. But, in reality, at the present time a number of tax agents—and I read this in the journals and whatnot of the various accounting bodies—are complaining about the tax office ringing them and saying: 'Would you chase up such and such a person's debt? Would you chase up such and such a person's tax return?' And they are saying: 'Hang on. I'm not your lackey. You do that directly yourself with the taxpayer. Here's his contact details.'

There is a process that has been followed since self-assessment came in here in Australia, which is largely unique to the rest of the world, that tax agents are given a nine-month period of time to lodge tax returns. In the US and in Sweden, the day after the third month, fourth month—whatever it is—every taxpayer, whether they lodge through a tax agent or not, has to have their tax returns in on that day. Here in Australia we give tax agents nine months, which gives to taxpayers an extension of time to pay their tax. If they have got a debit tax, it gives them extra time to get their receipts together to give to the tax—

CHAIR—Do you think that was also introduced for the benefit of the Tax Office, in terms of smooth—

Mr Vos—It certainly was when it was paper returns. I am not advocating this—my colleagues in the accounting world would have my proverbials—but the real issue here is that a number of concessions have been given to tax agents to actually fulfil the function of getting the material in from the taxpayer, getting the return prepared and having it lodged correctly. So tax agents have a lot of responsibility that I think is partly assumed to be on behalf of the Tax Office as much as

being on behalf of the taxpayer. They are not supposed to be there to maximise the refund to the taxpayer. They are there to get the right amount of refund to the taxpayer under the law.

Senator HUMPHRIES—I have just one more question for Professor McMillan. You are probably the statutory authority that has more contact than any other with disgruntled taxpayers. There were a number of comments made in submissions about the culture of the ATO. The Taxation Institute, for example, talks about ATO staff attitudes inimical to cooperative compliance, and CPO Australia talks about a pro-revenue bias on the part of ATO officers. What is your assessment of the culture of people who work in that office?

Prof. McMillan—If we see the Taxation Office through the prism only of the individual complaints that we receive and the contact we otherwise have, the evidence from that contact does not substantiate the general criticisms that are made. But I think what we do see is that every issue has two sides to it, and indeed that is the objective of the office. Examples have been given today. On the one hand, it is advantageous if the Taxation Office has flexibility in debt collection but, on the other hand, too much flexibility allows a debt to run on and creates horizontal inequity. There are problems if the Taxation Office rolls too many issues into a settlement with a taxpayer. On the other hand, our experience across all areas of government is that there is no better way of getting a relationship back on track between a person and a government agency than having a settlement that brings together the different threads of conflict.

There are complaints and difficulties if the Taxation Office has labels that are pejorative such as 'aggressive tax planning promoter' or whatever. On the other hand, it says it is failing in its response to calls from the public if it does not do that to differentiate between those who are innocent and genuine, committed and acting in good faith and those who are not. I think that is the general experience that we find. One can point to an issue or an example to substantiate a general point, but it is quickly counterbalanced by experience of a different kind or by imagining what the alternative is going to be if you take the other line.

Mrs BRONWYN BISHOP—Your staff basically comes from the Tax Office, does it not?

Prof. McMillan—No. Certainly I and my senior tax adviser have no background in the Taxation Office, and I do not think any members of our tax team have that background.

Mrs BRONWYN BISHOP—That is terrific because so often the ombudsmen draw their advisers from the department they are actually investigating. You do not—that is great.

Prof. McMillan—Our firm policy in recruitment is to try and recruit widely from inside and outside government. If we recruit a person from a particular department then, as a matter of internal policy, the person does not handle complaints in that area at least for a year. It is the same kind of policy that is espoused in other areas to create some distance.

Mrs BRONWYN BISHOP—Senator Watson reminds me that used to be the policy. It is good to see there is a new policy.

Prof. McMillan—Yes. Certainly the policy at the moment is to insulate the office—

Mrs BRONWYN BISHOP—That is good; that is excellent.

Prof. McMillan—from complaint handling by those who were involved previously in that area. But, as we often say, in every office there is the potential of bias. Everybody in the office is a taxpayer and everybody in the office drives a car or is involved in motor traffic and yet we oversee agencies in those areas.

CHAIR—That is good to hear too!

Prof. McMillan—So we need to have policies to insulate ourselves from it all.

Senator MURRAY—I want to deal with my questions in two compartments—firstly, the general experience for taxpayers and, secondly, what I would describe as class issues, things like the EBAs and mass-marketed tax effective schemes. Turning to you first, Professor McMillan, the complaints that you receive as a percentage of the number of taxpayers is very low, isn't it?

Prof. McMillan—Very low, yes. There are 10 million taxpayers, I think, and we have received on average in recent years about 1,500 complaints a year. One can draw that same analysis in other areas as well—Centrelink and immigration. I suppose the only point I would add is that sometimes we see a disproportionate number of complaints in a particular area, an example being super co-contribution. That scheme affected a comparatively small number of people and a proportionately high number of complaints, so we do a special study in that area to see if there is a difficulty with that.

Senator MURRAY—Let us take that as a ratio of those, for instance, who are obliged to pay a penalty, a debit or any additional tax over and above that which they have already paid or are expected to pay. It is still very low, isn't it?

Prof. McMillan—Yes.

Senator MURRAY—My feeling is that many Australians, perhaps most Australians, view tax liabilities as more like speeding than stealing—in other words, they have very little sympathy for somebody doing 180 in an 80 zone but they have every understanding of somebody doing 85 or 90 in an 80 zone, and if they are caught by the tax office, in the equivalent analogy, they cop it sweet because they think that is fair enough and they should pay it. To take the analogy a little further, before the introduction of drink driving many, perhaps most, Australians would drink drive. Now most Australians would think it wrong to drink drive. In other words, the culture has been changed; it is not just a question of penalties and so on. A few years back the British commissioner, I think it was, came out to Australia and said the thing to concentrate on with tax compliance is cultural change. I draw the analogy with speeding, drink driving and so on. I have seen no equivalent expenditure, campaign, intent or determination from the federal government or its agencies to change culture in an equivalent way. Do you as the Ombudsman think that is an issue?

Prof. McMillan—Certainly at the level of our interaction with the Taxation Office we do see evidence of the importance attached to cultural change. Probably the best example is the creation of the ATO complaints unit. A couple of years ago we made both an interim and a final report on ATO complaint handling, and the ATO accepted all of the recommendations and created the ATO complaints unit. Our experience is that it is probably equal to the best example of a complaint handling unit in an Australian government agency. It will handle anything up to 100,000

complaints and inquiries a year. There is some best practice in that area to ensure that complaints can be handled across business lines, that there is a differentiation between individual and systemic issues, and that management plays a role in the complaints process and it is not just a separate unit that sits aside from the rest of the office. That is a small example, but I think it is a good example of the recognition from within of the issue that you have raised about creating structures and programs that have a cultural objective as well as other practical objectives.

Senator MURRAY—Before I move on to things like PBAs and mass marketed tax effective schemes where you have a very large number of cases dealt with in a way which has raised great concerns, I want to take you back quickly to the remarks you made about big P policy and small p policy. You indicated to the committee that you were not able to raise big P policy issues. To me that is absolutely unacceptable. I would expect you to be able to raise them. My question to you is a simple one: does the statute that governs your office need to be changed to allow you to raise policy issues in particular circumstances?

Mr Vos—So your question is: should I have a broader remit or wider role? The government, through a process of putting it through a Senate inquiry in 2002, reached in 2003 legislation that gives me the responsibility to investigate systemic issues in tax administration and to provide advice to the government. The definition of tax administration is, broadly speaking, either the conduct of the tax office and all that it does or the underlying tax laws that determine the calculation of liability for tax or the enforcement of that liability through debt collection or the like. It is a very limited remit. It is, from what I understand of its background and the debate in the Senate, largely only to deal with the conduct of the tax office. There are very few little p policy administration issues that I can really look at. It is there to be able to be looked at, but there was no intention to go beyond that. It would be inappropriate of me really to suggest what it is that I would like to be doing. Do I want to be responsible for the whole of tax? It is a big enough job, to be honest with you, just dealing with the tax administration issue rather than worrying about whether the rate of tax in Australia for individuals should be this or that.

Senator MURRAY—Mr Vos, let's cut to the heart of the issue before us. I was right in the midst of that 2002 debate. Listening to you, there is absolutely no doubt in my mind that you will have policy views—quite rightly—arising from your experience. Within tax administration, as an example, a big policy issue would be whether all Australians should put in returns or not. That is perfectly within the area that you have already examined. My question to you is not about whether I want you to become the tsar of all tax. My question is: within your existing responsibilities, does your statute need to be changed to allow you, where you consider it appropriate, within your existing responsibilities, to raise large policy issues with the government? Your evidence to us indicated that you felt constrained in that.

Mr Vos—I guess I was guarded in my answer, simply to stress the point that I have no intention of going beyond my remit in my formal capacity, because that role would be ultra vires the legislation that empowers me. But as a private individual, I can do what I like in that sense, and approach the government. I guess I have had no need at this stage to be in the field that is being suggested. For instance, the issue about whether individuals should lodge returns goes to the whole gamut of self-assessment. If one looks at the explanatory memorandum of the bill that became my act, the review of self-assessment is my prerogative. The review of the legislation associated with self-assessment is my prerogative. The imposition of penalties, the imposition of interest—it is all within my remit. So I do not see that they are big 'P' policy issues. The big 'P'

issues are: are employees entitled to deductions for employment related expenditure? Is the rate of tax in Australia appropriate to be at 30c or 40c in the dollar for individuals? Those are big 'P' policy issues to me. Most of the policy issues that I am referring to today are within my remit, and I am not shying away from any responsibility to deal with them.

I think it is also important to make the point that I take on my review function what the community believe I should be looking at. I have wide discussions with the accounting, the tax, the legal and the business communities to determine my work program. And the legislation gives me almost a totally unfettered prospect for self-motion. So I do not believe that the legislation needs further empowering. I was just limiting my comments to the extent that, were there to be a big 'P' policy issue, I would not be wanting to buy into that.

Senator WATSON—With respect, Mr Vos, we are not talking about the big 'P' policy.

Senator MURRAY—I am, within his area. I do not like to hear of any person with your capabilities and competence, who is an independent individual, limiting their ability to communicate either with the parliament, with the government or with anybody else, in areas for which they have responsibility.

Mr Vos—Not one person in government or anywhere else has sought to fetter me in my comments or roles thus far.

Senator MURRAY—As long as you do not fetter yourself; that is my problem.

Mr Vos—I have sought to contain my role to a function that I believe I am (a) capable of performing and (b) legally obliged to do. To take the point that you have raised, it has been only within the last six months that it has been prudent for me to seek an opinion from the Australian Government Solicitor on just what I have the right to ask for and what the—

Senator WATSON—Could you table that opinion?

Mr Vos—No, I do not believe so; I believe that is privileged. But that opinion—just to put this on the table—was sought in conjunction with Treasury and Tax so that there was an understanding amongst all players that this is what my role is.

Senator MURRAY—You should know that senators respect but do not always accept the argument of privilege. We actually believe in transparency and accountability to the people of Australia. So, if your advice from the Government Solicitor was not such that you would feel it was in any sense commercial in confidence, perhaps you might reconsider your response to Senator Watson.

Mr Vos—I guess I am trying to give you a very favourable vibe that I know where my limits are. I am working within those limits.

Senator MURRAY—I am short of time. I must move on to the other area I wanted to cover. Mr Vos, I have been deeply embedded, for my sins, in the mass marketed tax effective schemes. I spent years on the Senate inquiries into that. I have held weeping taxpayers in my arms in places like Kalgoorlie and have had meetings with large numbers of those people. I know the

distress it causes. At the heart of that distress were three things. Firstly, people felt they had been deceived, to use your earlier word. They trusted the advice they were given. Secondly, they very strongly resented—again, a point you made—the implication that they were tax cheats, because they were simply acting as they thought legally to minimise their tax. Thirdly, they felt they were dealt with unfairly in two respects: it was retrospective and the penalties and interest charges were excessive.

It seems to me that at the heart of all that lies the issue of tax office discretion. The statute does not sufficiently limit that discretion. I would ask you, because we do not have much time, if you could perhaps think about whether you should give us a supplementary submission as to whether there are circumstances where the statute should be changed to require that discretion to be limited in ways in which it is not at present.

I take in particular the remarks made by Dr Emerson earlier about returns. Perfectly competent Australians do not understand what percentages mean, do not understand what compound interest means—do not understand things which intelligent, financially articulate people will assume that other intelligent, competent Australians will understand. They just do not understand it. In that respect, I think the tax office makes an assumption in its initial actions about classes of taxpayers which are detrimental to good process. I do not think we can explore this at length now, but I would ask you to consider whether you should make a submission as to whether there is any way in which that discretion can be packaged in a more manageable and more acceptable manner.

Mr Vos—I will undertake to consider that request.

Senator WATSON—There are two matters that you raised in your presentation that really were of concern to me. You stated that tax agents know and understand the law. With principle based law and the complexities of modern taxation, I tell you this is impossible. It is driving tax agents out of the profession so that in 10 years we will have a major problem. It is well known that tax practitioners cannot hope to keep up with the myriad changes. I know of a tax agent who is in there every morning at 6.30 and spends an hour and a half just reading material.

Principle based law gives rise to a whole host of issues which come through in journals and practice advice from the tax office, which often does not come out as early as people would like. The fact that it is now costing some of these small tax agents $1,000 an hour to go to one of the big four to get advice on these matters just shows that small tax practitioners are in a real dilemma. They do not fully understand the law. It is now just so complex because, while the thrust of the law might be self-evident, some of the strings that are attached to that, the consequences, subsequently become so significant as to create a dispute which puts a tax agent in a very invidious position.

So I have to say to you that I think you are wrong there. They should know the law in an ideal situation—but we are far from an ideal situation, particularly for the small tax practitioners. I fully agree with Senator Murray's proposition. The parliament does need an officer somewhere who is able to communicate with government. Whether it is by an official report or not I am not particularly worried, but where there are problems not with tax administration but with the way the law is formulated there needs to be someone to convey that. I do not think we can have the confidence that Treasury will automatically convey that. The parliament needs an independent

person such as yourself—or we might have to create a new post—who is able to come back to government to let us know if we have a bad law, a law which is badly framed or worded. We need someone to tell us of any unintended consequences or anomalies flowing from this. I am not satisfied that your statute provides you with the opportunity to convey that directly to government.

Mr Vos—I will start with your first point. I was looking at the issue on tax agents in an absolute sense. I direct the committee to an ABS review that was done around about 2002 on accounting bodies. Sixty per cent of accounting firms are sole practitioners with 1½ to three staff, including the principal. Most of the tax agents, I would imagine, who are lodging tax returns in Australia are sole practitioners. Most of them are struggling. But the system assumes that they know the law. I am making that point.

Senator WATSON—That is better. You did not say that earlier.

Mr Vos—Okay; well, the system assumes that. I have made some observations today that need to be challenged, and you are right to bring that point up. Tax agents need support. That is the thrust of one of the parts of my submission. I have said in it that if the tax office cannot do it then the government has to guarantee that it can be provided. That is where I left it. I did not go beyond that because at this stage it is a circular argument. If you do away with tax returns for individuals, for instance, you are getting rid of 10 million returns. That is not on the agenda today.

Senator WATSON—I am not referring to the returns that Block type institutions prepare, which are basically salary returns; I am referring to tax agents who deal with small to medium businesses who are really struggling to keep up with the complexities and the consequences of the law and their personal liability that they now have to incur.

Mr Vos—I think in this review we all need to keep in mind that taxpayers have to have a right for certainty in this system. They go to tax agents. It is too costly, so it seems, to go and get a ruling.

Senator WATSON—Why is it costly to get a ruling?

Mr Vos—If a tax agent prepares a ruling, at the moment the tax office requires the tax agent to list all of the cases that might be referable for them to consider and to put in writing what they think the answer should be.

Mrs BRONWYN BISHOP—A brief revised.

Mr Vos—Correct. Taxpayers are not prepared to incur that cost. Tax agents do not have the time to put all that information together in a submission to the tax office. They do not have the time to wade through cases and the like.

Mrs BRONWYN BISHOP—But don't we have an obligation too, as legislators, to make sure that the legislation is comprehensible?

Mr Vos—That is where I was just about to finish up. That is an issue that the committee needs to consider; but it is the process of parliament that has made the law, and it has to be taken into account in that context.

CHAIR—All of those issues will be considered over the many weeks and months of our inquiry.

Dr EMERSON—My question follows on directly and might be born out of naivete. What do both Mr Vos and the Ombudsman think about a simple idea where there might be some uncertainty in what the tax agent is proposing, and the tax agent simply writes a letter to the tax office which says: 'This is my interpretation, and I am relying on that.' They are not seeking a private binding ruling but are simply saying: 'Here's everything on the table. I'm not trying to do anything sneaky. This is my understanding of the law.' They are therefore being fair dinkum and making available to the tax office the information upon which they have made that assessment.

Related to that, Mr Vos, you make a very strong statement in your submission, which says:

> The administration and operation of the tax system may be at serious risk of breakdown within the next decade because of a failure to address an unsustainable reliance on tax practitioners.

That is a very strong statement, and it might be an ideal basis on which to wind up your evidence today.

Mr Vos—I will take the first point. The reference in my submission to 169A is precisely to that issue. In the early stages of self-assessment, you could draw the attention of the tax office to a particular part of a return that you had prepared and lodged and say: 'Look at my capital gains tax calculation. Look at the deduction for my investment. Tell me what you want on it' or 'Here is a full disclosure of all the material facts.' The tax office would make a risk analysis of that stage and decide: 'Let it go, because it is only a small amount of tax,' or 'Let's go and look at it and make a judgment.' That was aborted when the PBR system came in, because the perception was that the PBR system would deal with that. I am suggesting that that is an opportunity. The law is there. The commissioner could just bring it back in.

Dr EMERSON—Maybe we should return to that.

Mr Vos—Going back to your other point, I think there is a causal link to the comments by Senator Watson. I am saying that as tax agents these people should know. Senator Watson is saying that they are battling to know. Regulation of tax agents is coming in. I am suggesting that there could be a point where a large number of tax agents say, 'This is all just too hard; I am walking away' or the practitioners registration board—or whatever they have in mind for calling it—will potentially say: 'You, David Vos, are not competent to prepare tax returns for corporates and for business. You're only competent to prepare tax returns for individuals; therefore, we're giving you a restricted licence to prepare tax returns only for individuals.' There might be plenty of H&R Blocks around, but there may not be the types of tax agents that Senator Watson wants.

Prof. McMillan—I have a quick response to the question about levels of advice. It is part of the responsibility of a government agency to respond to questions of all kinds—formal and informal—and at all levels. The issue becomes: what reliance can be placed upon the advice by

the person? What your question brings out is that it is important for an agency, including the Taxation Office, to have a policy that is understood by people about the purpose for which the advice has been sought and the reliance that is placed upon it.

To give the two ends of the spectrum, at one end there is the private binding ruling system—which I think is very sensible; and, at the other end, people should be able to ring and get informal oral advice. For example, the Child Support Agency has just instituted a system whereby people who ring for oral advice are given a registration number, much like what a bank gives you when you have an interaction, to take away that uncertainty and field for debate.

Between those two ends of the spectrum, there is a necessity for government agencies to also respond in writing to questions that are asked but when doing so to clarify both for themselves and for the person seeking the advice what reliance can be placed upon it and what onus is upon the person seeking the advice to provide information for the purpose of the advice. We get this issue all the time. One of the questions we always ask is, 'Let's look at the whole interaction to see what is sensible.'

Dr EMERSON—I guess what I am saying is that the agent might say: 'This is an area that looks a bit ambiguous. This is what I've done on behalf of my client.' I am not necessarily saying that the tax office should give an absolute decision when they get that letter. But at the very least you would think that it would affect any decisions about interest charges and penalty tax.

Prof. McMillan—And it should, but they then should not be able to bruit that abroad and say, 'I have a ruling.'

Dr EMERSON—No. This is just an individual case.

Prof. McMillan—It is a question of degree.

Mrs BRONWYN BISHOP—Did I understand you to say that section 169A is still operative in the act?

Mr Vos—It is.

Mrs BRONWYN BISHOP—And the commissioner chooses not to deal with it?

Mr Vos—No. There is another provision that says that where there is a right to go and get a PBR you cannot use 169A.

Mrs BRONWYN BISHOP—There is always a right to get a PBR.

Mr Vos—Yes, but it is still there—that is what I am getting at. You would need a legal amendment to bring it back into action.

CHAIR—That is probably something that we can follow up with the Treasury. Thank you very much for your evidence this morning. Thank you for allowing us to go over the scheduled time. That was most valuable evidence to our inquiry.

Proceedings suspended from 11.52 am to 12.03 am

DRUM, Mr Paul Joseph, Senior Tax Counsel, CPA Australia

CHAIR—Welcome. Do you have any comments to make on the capacity in which you appear?

Mr Drum—I am a member of CPA Australia and I am also the organisation's Senior Tax Counsel. In that capacity as an employee I have a role of looking at policy, legislation and administrative type issues. So I am not only here to represent the members; I want to make some introductory remarks about the organisation before we get to our submission.

CHAIR—I invite you to make a brief opening statement and then the balance of time will be allowed for questions.

Mr Drum—Many of you will be familiar with CPA Australia.

Senator WATSON—Before you start, can you also in your opening statements comment on issues that you heard raised while you were sitting here earlier, where you might either agree or disagree, that may not have been in your submission?

Mr Drum—Okay. Firstly, I will give a brief overview of CPA Australia. CPA Australia is a member service organisation with core services in education, training, technical support and advocacy. As a professional body in the finance, accounting and business arena, it seeks to act in the public interest first and foremost. At the end of 2005 we had more than 108,000 members in finance, accounting and business advice. We are the largest professional finance, accounting and business body in Australia and the sixth largest accounting body in the world. I will leave that there.

With respect to Senator Watson's questions and evidence that I have heard this morning, we would also like to make some comments about the National Review of Tax Agent Standards. That is not something that we covered in our submission, but I think it might be of interest to the committee to understand where CPA Australia is currently at with respect to that review and the bigger question, I guess, about the future of the tax profession. Thank you.

Senator WATSON—The principles based approach really puts a big ask on tax agents—members of our profession. For the record, I have to disclose my interest as a fellow of the CPA. The principles based approach is beginning to worry me in the area of technical and complex law. It requires an understanding of practice guides from the tax office, lots of pamphlets that are issued by the tax office and information that comes through journals from professional bodies, such as yours, the Institute of Chartered Accountants and the National Tax and Accountants Association. Accountants are spending so much of their time trying to understand the law, and the cost of understanding that law is beginning to be quite outside the pockets of middle-sized businesses. When a person asks an accountant, for example, about a problem, some will say, 'I have to refer that to our adviser.' It goes to a second line adviser on the mainland, a specialist, at $550 per hour. Higher advisers cost $1,000 per hour. When you come back to the client, the client will say, 'You make the decision.' That is a real problem. The tax agents, members of our profession, find themselves with what I call principles based law that is highly complex.

Mr Drum—We agree that there is a problem with how the laws are currently constructed or drafted in Australia and the complexity of our current tax system, a lot of which lies in the law. However, with respect to principles based drafting, there are not a lot of examples of it actually being put into place in the tax law. The most recent example is the current TOFA stages 3 and 4 exposure draft provisions, which were drafted in a principles based drafting style. Senator Watson, we share your concern as to whether this is the answer or the way forward in legislative drafting as a way of simplifying things. It seems to create a problem in itself in that it creates a greater necessity, if you like, for further clarification by way of rulings, regulations or something else by the actual regulator, the tax office. Having principles that are easy to understand at the general level is a worthy objective to strive for in drafting. However, in practice, business advisers and taxpayers need certainty. We need to view that certainty in the law rather than in drafted generally based statements that then require quite a lot of technical detail at the administrative level.

Perhaps tax consolidation, which came out of the review of business taxes, is a recent example of extraordinarily complex legislative provisions. Some dozens, if not a hundred, rulings or explanatory statements have been necessary to follow up and explain how the whole thing operates. That is an example of recent drafting of some complex provisions that try to deal with complex matters—there is no doubt about that. It really raises the question: if you have some brand-new law and you then have to write a whole lot of rulings, was the law drafted appropriately in the first place?

I want to add to that and again say that we have a complex economy, that we deal in a complex market and that a lot of the complexities in our tax laws are about anti-avoidance measures or about ensuring that a particular group of taxpayers, as opposed to other groups, gets a concession. I do not know how we can overcome the kind of complexity where there is specific drafting to give specific intent that is not meant to have wide application to all taxpayers. I just make that observation.

Senator WATSON—Would you accept the concept of a pilot scheme arrangement whereby a client could indicate on the front of their tax return that they wished some aspect of it to be dealt with under the old tax assessment system? That might not appeal to too many people, because they like a refund within 14 days or whatever it might be. However, some of the practitioners whom I have been referring to might be having trouble in an area or they might not be certain about an area—whether it be capital gains or an anti-tax avoidance measure. They could tick that box and then give a whole lot of information to the tax office like we used to provide in the old days about repairs and maintenance, names, individual amounts, who they dealt with, architect certificates as to whether it was a capital work or a repair—all of that sort of thing. Obviously the tax office is going to take a bit longer, but it would be able to assess that aspect of the return.

Mr Drum—I draw your attention to our submission under ‘Impact of Self-assessment’, where we talk about the proposal of giving consideration to a modified system for certain taxpayers. Your question touches on that. That would be one way of addressing that. The concern that we were raising was that small business taxpayers, because of costs and other things, do not want expensive litigation and penalties further down the track. They want some certainty. In some ways certainty has been addressed, if you take, for example, the recent ROSA—review of self-assessment—review and the two-year period for taxpayers who elect to go into the simplified tax system.

Senator WATSON—That is marvellous.

Mr Drum—That is a very positive step and it is an extra incentive for those taxpayers who qualify, which has also been broadened as part of the May federal budget announcements. That is a terrific measure. However, those taxpayers who do not qualify or who do not get in are still out in the cold. They have four years of uncertainty on some matters. Some of the things that they might be dealing with, for example, if you are talking about small business type taxpayers, are capital gains tax concessions or roll-over or retirement exemptions. They might be once and for all type payments—the only time they ever think they are going to be entitled to a lump sum. It is meant to be there to fit hand in glove with their overall retirement savings strategy. Then they find out four years later that they did not get the gain or as much as they had expected or it was not tax treated in a particular way. That would be one way of addressing what we are talking about. We are favourable to having a look at that type of initiative.

Senator WATSON—Have the private binding rulings developed in a way that was unintended? We heard evidence today that taxpayers have to put up the pros and cons rather than the facts of the situation. It would worry me, for example, if a taxpayer had to provide legal precedent as to why. They can do it if they wish.

Mr Drum—Yes.

Senator WATSON—But it would worry me if it were a requirement in seeking a ruling. I would have thought the whole intention of the ruling was that it was supposed to be a cost-effective method of providing some certainty in the law. But it would appear that there is now a considerable cost in getting a ruling. Could you comment on that? It would be unfortunate if we moved in that direction. If so, why would we move in that direction?

Mr Drum—I must say that I am not sure of a legislative requirement that a taxpayer or an adviser on behalf of a taxpayer is compelled to put in all the legislative relevant case rulings in preparing a private binding ruling. But I think the real issue is that—

Senator WATSON—That was tendered in evidence though.

Mr Drum—I understand that, and I would have to check whether that is factually correct. My understanding is that the tax office might have a habit of asking for that type of information and encouraging taxpayers to submit that in an effort to ensure that they meet their targets, and it helps facilitate arriving at the answer and getting the private binding ruling back to the taxpayer in a timely manner. As you know, the private binding ruling system is meant to work in a 28-day turnaround, so I think it is more an encouragement rather than a legislative compulsion that they must provide all this information. It does talk about setting out exactly what the issue is that you want addressed, and I think the rest is ancillary and helpful but not required. I do not think they are going to reject an application for a private binding ruling in the absence of cases being provided by the applicant.

Senator WATSON—Where advice is given over the phone, we are told that the tax office institutes a registration system. Shouldn't that registration system be followed up with a letter of advice to the tax office indicating how they understood the nature of the advice and the advice

that was given, otherwise the tax office could well have put an interpretation different from what the taxpayer thought they were talking about.

Mr Drum—What you are suggesting is that the taxpayer then write back to say, 'This is my understanding—

Senator WATSON—No. You ring up and get a registration of that advice, but I am saying that the tax office should then provide in writing that advice and the reasons that advice was given. In other words, they understood the background. If they did not understand the background, you are obviously going to get wrong advice. It is a bit like people asking for advice on the phone—it is always very dangerous, because they may interpret it differently to what you understood the facts to be.

Mr Drum—It may assist, but cases turn on the particular facts. So even if such a system were implemented, the omissions of material particulars is really a test. So even if they wrote back and said, 'This is what we have discussed and this is what we understand to be the facts,' I am still not sure that provides the absolute certainty that a taxpayer is looking for.

Senator WATSON—What is the purpose of registration if you are not really going to do much with it so far as the taxpayer is concerned? That registration must be accompanied by some written comment by the person at the call centre that this issue was addressed in some manner.

Mr Drum—I do not know whether this system has been assessed yet. We are not seeing, for example, cases of the tax office going out and doing audits and finding that they have given advice earlier and the taxpayer has not stuck to the advice. I guess in our case the jury is still out on how that onus of proof rates and whether it has been effective or not. So I cannot really put forward an organisational view on the question you are asking.

Senator MURRAY—There are two areas that I think need addressing in tax law. One is the whole complexity issue, which just has to be diminished. I am delighted at the Treasurer's decision to lop off a whole lot of unnecessary legislation. It probably does not have the credit it deserves—just getting rid of lots of stuff. I want to deal with certainty, if I may, in this discussion.

With most agencies, if the statute is insufficient, regulations are constructed and are almost always legislative instruments that pass through parliament and have that additional check on them. With the tax office, statute that is inadequate and needs further development is, generally speaking, developed through the process of rulings, not through regulations, and they are not legislative instruments. Plainly, private rulings could not be of that form. But with public or class rulings, my first question is whether it would be an added element of rigour and a constraint on discretion, if you like, if those were required to be legislative instruments and approved by parliament.

Mr Drum—At the moment, public rulings are binding on the commissioner anyway, so there is a degree of rigour around that in that the commissioner must follow his own public rulings.

Senator MURRAY—But they are not subject to parliamentary scrutiny.

Mrs BRONWYN BISHOP—He can change his mind when he likes.

Mr Drum—That is quite correct.

Senator MURRAY—Let me explain it to you this way. The reason that delegated legislation is dealt with in the way it is goes back to the oldest and, in some respects, one of the most respected Senate committees, the Regulations and Ordinances Committee, which was designed four or more decades back—it might go back to the 1920s—to make sure that delegated legislation was in accord with the statute. At present there is no way for parliament to have a mechanism to ensure that public rulings are in accord with the statute. It is entirely at the discretion of the commissioner. It may be changed by any commissioner at any time. I want to know if you think that is the best process.

Mr Drum—I can see the benefits of what you are talking about, but it is not something that I can convey an organisational view on today. I have a personal view on it.

Mrs BRONWYN BISHOP—Tell us.

Mr Drum—I think there is a lot of merit in that, because it ensures that legislation created by the parliament is operating as it was introduced and intended to operate and that it is delivering on its original policy objectives. It is not something that we have discussed recently, and I cannot give an organisational view, but that is my personal view.

Senator MURRAY—Tied to my question is this: I think principles based law has its place and cannot be universally applied. It is a circumstance issue. But even where it is appropriately put into statute, I suspect that it will be negated by rulings which will in fact be black-letter law and we will go back to a prescriptive approach, not a principles based approach, anyway. So that is a concern. The second area of my question to you really follows on to things I said to Mr Vos earlier. You might want to take it on notice and give it more thought, but feel free to answer if you wish. Do you think that discretion of the commissioner needs to be boxed in somewhat or restrained or should be required to be dealt with in a particular way? Again, if I can give you a legislative example, it is quite common with statute, in respect of any judicial examination or perhaps examination in an administrative process, that certain circumstances must or may be taken into account. That effectively boxes in the discretion that the judge or the administrator or the decision maker may take. There is not much of that in tax law, from memory. Discretion is mostly pretty open-ended. Perhaps you could give me a response and come back to the committee with a further submission if you wish.

Mr Drum—We do have an organisational view on this—rather than just my personal view this time—and that is: we think that it is appropriate, for the effective administration of the tax laws, for the commissioner to have certain discretions. I guess we generally would prefer to see that those discretions would have very little dispute if they were being exercised in a favourable way to taxpayers, rather than 'pro-revenue bias'—which is an expression used earlier this morning. Sometimes to make the thing work we need the commissioner to administer the laws of the day and he has general administrative powers. Using those general administrative powers, he might decide that he is going to pursue certain things a certain way, and that might include deciding not to pursue certain things or not to apply penalties or those types of things, rather than being compelled by black-letter law. We think that is appropriate in a balanced tax regime.

Senator MURRAY—I must say that I agree with you. I am not inclined in remove discretion, because discretion is necessary in many circumstances. But I will draw your attention to some of the remarks made by Mrs Bishop earlier. That is where the tax office—and they have improved their process since; I must make that qualification—has issued class determinations which ignore individual circumstances and the adjustments that were necessary to deliver equity as well as the necessary revenue result. That was in the mass marketed tax effective investment scheme. It required massive public and political uproar for discretion to be judiciously applied and for a more sensible approach to be taken. In the meantime, literally thousands of people, families and in some cases businesses were put under enormous stress. There were some suicides and great personal drama. The discretion was inappropriately exercised.

There is no mechanism yet, that I know of, to prevent discretion being inappropriately exercised at some future date, because the essential statutory environment remains the same. It is dependent upon administrative and personnel systems and the character of those involved.

Mr Drum—Noted. I do not know whether I can add much to that. The period of the mass marketed schemes was a very sad period in Australia's history. We know that great pressure had to be brought to bear before the commissioner acted, looked at concessions, wound back penalties and original assessments and that type of thing. We would hope that the administrators, and taxpayers as well, have learned a lot from that. It is not going to prevent the same type of thing happening in the future. Many would have said that mass marketed type schemes, large-scale tax avoidance schemes, were a thing of the past after bottom of the harbour, but then they came back in a different form many years later. We currently have Operation Wickenby that the tax office is undertaking, which would seem to be another form of tax avoidance on a pretty wide scale. A lot of dollars are involved.

Senator MURRAY—I would like you to consider whether you should come back to us on this. My view is most parliamentarians would take the view that discretion is appropriate, providing it is appropriately applied. There is a lot of wriggle room in there for anybody. However, there are two ways in which you can constrain discretion: one is by setting out in statute the sorts of things that must be considered in coming to any decisions; the other is by requiring that where you take action which is applicable to a class of taxpayers as opposed to individual taxpayers, you have a formal process for checking it off or ticking it off—in other words, it is ironed out by some independent body to which the tax office must present its plans. That mechanism does not exist at present. As far as I am aware, there is no premechanism by which the tax office could go to the Ombudsman, the professional associations or the Board of Taxation, or whomever you might think of, and say: 'We're proposing to deal with 40,000 taxpayers in this way because of this problem. Can you see any difficulties or can you raise any difficulties with what we are proposing to do?' I do not think there is that external probity check.

Mr Drum—Sure. I appreciate that there is no formal mechanism. But in respect of the mass marketed schemes, the tax office did ultimately categorise taxpayers and treat them differently. The professional tax, accounting and legal associations were actually involved in developing some criteria that influenced the tax office's thinking in the way that that was ultimately played out.

Senator MURRAY—But as you know that was set up as a result of public and political pressure by the Senate committee. That was established between the Senate committee and the

tax office, and then they went out and consulted further. I am talking about anticipating events and issues. We are not here to deal with the past, although that matters. We are here to ensure that the tax office is able to take appropriate action in the future on a basis which is likely to result in good outcomes, and not a community and legal disturbance.

Mr Drum—Okay. We will undertake to have a look at that.

Senator MURRAY—Do you understand what I am on about?

Mr Drum—Yes.

CHAIR—Could you make a supplementary submission?

Mr Drum—Yes, that is our undertaking. We will look at that matter and write to the committee again. I understand you will be meeting for some time to come.

CHAIR—We can certainly take supplementary submissions from you on the matters Senator Murray has raised. Also, through the course of our hearings, if there is any other issues you wish to raise you can make as many submissions as you want and they would be very much welcomed by the committee as part of our deliberations. Don't feel that this is your one and only chance to have your say. You may see various matters reported from time to time as we move around the country. If there is something you wish to add, please do so.

Mr Drum—Sure.

Mrs BRONWYN BISHOP—I am particularly interested in two parts of your submission. The first one is the need for an overhaul of the simplified tax system to make it more attractive to small business. Twenty-seven per cent participation is a very low rate and I think it indicates that it is not a very successful policy.

Mr Drum—I think, on the one hand, that is an interpretation that you can arrive at but, on the other hand, there is still a period of getting to know what it is all about. Given that this original submission was made in March this year, you will appreciate that there have been further changes to the simplified tax system as recently as 9 May this year which we think broaden things out. It lifts the $1 million threshold to $2 million. There are other changes: it removes the $3 million depreciating assets test as a requirement from 1 July 2007 and it also will ensure that STS taxpayers will be eligible for the CGT small business concessions without having to satisfy the net assets test. So there are actually extra features being put into STS, so there have been some changes. I know that they are not strictly exactly as we wrote in our submission. We talked about lifting the turnover threshold from $1 million to $5 million and indexing it, but we are up to $2 million and I think that is a very positive step. Perhaps we could wait and see what the uptake is in respect of these new initiatives. Given that a lot of them only start from 1 July 2007, we may not know for some time.

When the STS provisions were originally drafted, one of the issues of some concern to Treasury at least was in respect of the depreciating assets and the turnover—what kinds of taxpayers would fall into that area. There was talk about capital intensive industries—primary producers and manufacturers. There was some concern about the mining sector, in that there was

perhaps a question mark about what the measure would cost in budgetary terms if it were much broader. With STS we see that Treasury at least, in developing this with the government, has been feeling its way about what the actual cost is to the revenue and whether it is affordable. This is like the next step. I think that these new features will make it much more attractive, provided that taxpayers know about them.

There is also the entrepreneurs offset that was put in as part of that not long ago. I spoke to one of our public practice discussion groups on Monday night about their obligation with regard to taxpayers—who they might not have even bothered discussing STS with, because they said that there are no benefits in it for them—and that it is incumbent on them to look at that and make sure that their clients are making informed decisions about whether they want to elect in or not when the provisions apply. There is not much else to add on that at the moment. We think it is going in the right direction.

Mrs BRONWYN BISHOP—Very quickly, there are two other particular bits. One is the operation and administration of the pay-as-you-go system. Firstly, one of the aspects of that that I really find offensive, as somebody who went around selling the benefits of the new tax system, the GST and its implementation, was that we made a statement that we would abolish provisional tax but we did not do that; we simply called it something different. We removed the eight per cent GDP uplift factor. Earlier, we discussed with the inspector-general the overcollection of tax—that the government overcollects $15 billion every year and has the use of taxpayers' money for free. Regarding one of the reasons, in your submission, you say:

... the seven per second 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.

Would you like to comment a little bit more on that?

Mr Drum—Yes. There are two points to make about that. The first is about the churn effect of the PAYG withholding tax. An enormous amount of money is effectively taken on loan and then returned to taxpayers, so they overpay during the year and get something back at the end. We think that can be finetuned. The amount does not have to be as large. The second is that, in respect of the GDP uplift arrangements, we are supportive of another method. You might recall that, prior to this quasi-provisional tax being reinstated, taxpayers had to calculate their PAYG on actual figures, which created a quite significant compliance burden. Choice also creates complexity, as you know, but taxpayers, under this method at least, had a choice: if they did not want to go through that, they were not having that much contact with their advisers and they did not want to do it themselves on a regular basis, they could opt into this. So, from a low compliance cost point of view, using the GDP method does have some attraction.

However, the uplift factor, as we pointed out in our submission, is quite significant. Looking at the finetuning, we are supportive of the alternative option, but does the uplift factor have to run that high? In our submission we referred to other issues, such as fluctuating incomes and businesses not being able to guarantee. I am just not sure how we can deal with those issues. The GDP method is rather inflexible. If you go outside it then you are immediately put back into the other system. We just think that some more work needs to be done on that, but I do not have the exact answer for you today.

Mrs BRONWYN BISHOP—Do you think that a system of quarterly payments is fair? It gives the government money earlier, but is it fair to taxpayers?

Mr Drum—There is a capacity-to-pay question here about collectability. It does have the benefit of encouraging people to make regular small payments instead of being hit with a large bill at the end.

Mrs BRONWYN BISHOP—But don't all sorts of businesses face the great difficulty that certain parts of the year can be dead yet they still have to find that money?

Mr Drum—Yes, they certainly do. Since the implementation of A New Tax System and the GST, it is inevitable that businesses have to be much savvier about their cash flow on an ongoing basis for a whole range of things. I think it is an important feature, if the revenue is going to be collected, if the money is going to be there, because the risk to the revenue is whether the money is going to be there for a once-and-for-all annual payment or whether the taxpayer is still going to be in business. I think it is a kind of necessary evil.

Mrs BRONWYN BISHOP—What was the record when provisional tax was paid annually? People paid, didn't they?

Mr Drum—We have proposed in respect of certain small amounts that there could be an annual payment, that you could make an annual wash-up payment, so we are certainly supportive of that. However, just generally speaking, there is a place for the quarterly payments system.

Mrs BRONWYN BISHOP—But shouldn't you have the option as to whether you pay quarterly or annually, just like you do for GST?

Mr Drum—Yes, but subject to the appropriate caps. We would need to consider the dollars involved.

Mrs BRONWYN BISHOP—Would you like to consider that?

Mr Drum—Sure.

Mrs BRONWYN BISHOP—Just on that last point, I was delighted to hear Senator Murray raise that question of the commissioner making public rulings. It is one I feel very passionately about. I am glad to hear your personal point of view. I would love to hear it backed up by your organisational point of view.

CHAIR—You are welcome to put in a personal submission as well, I should add.

Mrs BRONWYN BISHOP—Yes, absolutely. But, as a legislator, I would like to see the legislative function come back to the parliament. I know the commissioner says he is merely interpreting, but I am afraid that is not my definition of interpretation.

CHAIR—Mr Drum, thank you very much for your evidence today.

Mr Drum—Mr Chairman, I did mention that, if there was time, I would talk a little about the national view of tax agents' standards. I do not know whether Senator Watson had a particular question on that.

CHAIR—You have made those points in your submission, haven't you?

Mr Drum—No, there is no comment on it.

CHAIR—Would you like to make a supplementary submission on it?

Mr Drum—Certainly. I will deal with that in a supplementary submission.

CHAIR—That would be a better course of action. We do want to hear from a range of witnesses, but we are at a point in time where further discussion will limit the time of our next witness, who got up at 4 am to travel all the way from Shepparton. We will be having a Melbourne hearing as well, so if you felt the need to come to talk to your supplementary submission I think we would be able to arrange that.

Mr Drum—Thank you, Mr Chairman.

CHAIR—Thank you very much, Mr Drum.

[12.43 pm]

McKENZIE, Mr Ian William, Private capacity

CHAIR—Welcome, Mr McKenzie. Do you have any comments to make on the capacity in which you appear?

Mr McKenzie—I am a registered tax agent and a member of the National Institute of Accountants, the Taxation Institute of Australia and the National Tax and Accountants Association.

CHAIR—We note that you have made two submissions—one with a range of suggestions about the penalties regime and certain things both the tax office and government could be doing with compliance, and a supplementary submission on a separate question relating to capital gains tax and the keeping of records. Would you like to make a brief opening statement before we proceed to questions?

Mr McKenzie—No, it is fine to proceed to questions.

Senator HUMPHRIES—Mr McKenzie, first of all, can you tell me what cabbage patch accounting is, please?

Mr McKenzie—I term it the invention of things by accountants to justify what they are doing for their clients, making up stories so that they can bring in a piece of legislation and apply something in favour of the client—in other words, a bit here and bit there and it all comes together, but in the event of an audit by the ATO there will be some uncertainty about what the accountant or the tax agent has done on behalf of the taxpayer.

Senator HUMPHRIES—And this is an illegal exercise, or on the fringes of being illegal?

Mr McKenzie—What I constitute as a grey area may be deemed to be illegal by the tax office. It may also be in the grey area of being arguable within the law.

Senator HUMPHRIES—And you say that the majority of tax agents and accounts are deliberately abusing the system. That is what you mean, isn't it?

Mr McKenzie—That is correct.

Senator HUMPHRIES—What do we do about that?

Mr McKenzie—I think what needs to happen involves section 251, dealing with the administration of tax agents and the qualifications of those people who become tax agents. I will just go back one step: when you build a house, you put in strong foundations and then you build your walls and it stands solid. I believe the tax system should have integrity and strength. It really is an internal revenue raising system, because it is our money, and it needs to have some strength that supports the law.

About 75 per cent to 80 per cent of taxpayers use a tax agent, under the self-assessment system, to prepare and lodge their tax return, so you need to have that strength there in tax agents. In 1987 the rules and guidelines for tax agents were changed in section 251. One of the problems at the moment is that you can have a registered tax agent who may be a barrister but not a member of any accounting body. He does not have to do any compulsory tax training. He might be a registered tax agent but, because he is not a member of any accounting body, he is not bound by any accounting body to do his 30 or 40 hours a year of structured learning—that is, classroom activity.

Then you have the problem of some registered tax agents who are not a member of any accounting body. Again, they have no compulsion by law or by any other means to have to do structured training. What comes across from new clients who come to my practice is that, because these agents are not forced to do structured learning and yearly training, they do not keep up to date because they are too busy or too lazy to do it. So you need to strengthen the base that supports the integrity of the tax system in law.

Senator HUMPHRIES—Excuse my ignorance, but who registers tax agents?

Mr McKenzie—The Tax Agents Board.

Senator HUMPHRIES—Obviously they would have to have minimum qualifications to get registration. Is there a requirement for ongoing education in tax matters to continue their registration?

Mr McKenzie—No, there is nothing in the tax act that forces registered tax agents to do compulsory training. That is one of the pitfalls of the system. The other problem with the system is that I believe the tax agent's registration is a licence and that the tax agent should appear before the board that has given it to him. It is not a face-to-face interview. If the tax office and the government were to strengthen the rules for registered tax agents who prepare taxpayers' tax returns then that would add a lot of integrity to the tax system. That is my opinion.

Senator WATSON—Can you outline to the committee the problems of being a country tax agent. Where do you go for your support and guidance?

Mr McKenzie—It differs from tax agent to tax agent and accountant to accountant. I have a group of people around me, mentors, to whom I can go if I have any—

Senator WATSON—Who are these mentors?

Mr McKenzie—I have senior people. One man is a professor in tax. So you build up a network of peers around you. You also have the tax office website. I ring the ATO if I am in doubt. You use research material. I have a professional library that I buy. Most practitioners, if they are prudent—and I think they should be—should have some form of finding out about that support and about ongoing training in Melbourne.

Senator WATSON—How many hours per week on average would you give to keeping yourself up to date with tax laws and practices?

Mr McKenzie—I could not put a figure on it. I have information coming from all sources. Sometimes it might be five hours a week. I might not then do anything for two weeks. Sometimes I might spend a whole weekend at home reading material just at my own leisure.

Senator WATSON—So you could not give a time that it takes you approximately? Is it 20 hours or 10 hours a week, averaged out?

Mr McKenzie—I honestly could not put a time figure on how much reading I do.

Senator WATSON—I am a bit surprised that, as a tax practitioner, you have come up with a recommendation for harsher penalties for noncompliance.

Mr McKenzie—Absolutely.

Senator WATSON—I am not sure. What do your clients think? Are they happy with that? We have had a few submissions today about the severity of the impact of some of these harsh penalties. If anything, I think the committee would probably be moving away from the harsher penalties. I was a bit surprised when I saw that in your submission.

Mr McKenzie—Senator, what do you do with tax agents who are deliberately being shonky and doing—

Senator WATSON—Do you think there are many of them around?

Mr McKenzie—I have seen plenty of evidence in my time. Sometimes the taxpayer is not aware until they change tax agents that the other accountant or tax agent has done something wrong that does not appear to be proper.

CHAIR—Just to nail that point that Senator Watson has drawn out—and we are all under privilege—what would be the motivation for a tax agent to do that? Would it be to get a bigger return to charge a higher fee? Would that be the motivation?

Mr McKenzie—I would say that they would have a larger client base.

CHAIR—So they would say to the taxpayer, 'You can claim more deductions than you have been,' and on the basis of that the tax return is more expensive and the fees more significant. Then the taxpayer would hypothetically go to another tax agent who says, 'Well, no, actually you can't claim all those deductions. Consequently, your return is less time consuming and my fee is lower.' Would that be it?

Mr McKenzie—No, it is not necessarily the fee. Taxpayers talk to each other out on the street and could think: 'If Joe Bloggs can do this, how come I can't do that?' I quite often explain to the taxpayer that you are comparing apples with oranges. But there are taxpayers who deliberately seek out tax agents who will deliberately put some so-called illegal entries into the tax return, and they are comfortable with taking that risk. What I am saying is that there are taxpayers out there who deliberately take risks to get a bigger refund or a larger deduction in their tax return.

Senator WATSON—It tends to suggest that perhaps the self-assessment system has given rise to a situation where people either do not understand the law or are not prepared to understand the law and, because of the four-year time frame, are prepared to take risks. How widespread is that amongst clients and amongst tax practitioners?

Mr McKenzie—That is amongst taxpayers. As I said, taxpayers will take the risk to find a tax agent who will do what they want them to do in their tax return.

Senator WATSON—But you said there is a bit of shopping around.

Mr McKenzie—They do, absolutely. That has been confirmed to me by officers from the ATO. The ATO are well aware of the fact that taxpayers shop around to get a bigger refund.

CHAIR—Would they seek to do that on the assumption that there will be less scrutiny by the ATO than if they simply filled out the return in *TaxPack* and sent it in?

Mr McKenzie—No, I disagree with that comment, that there is less scrutiny.

CHAIR—No, they would assume, not that there is less scrutiny. We had earlier evidence that there is a general perception that, by virtue of the fact that taxpayers are using a tax agent who electronically lodges their return, there will be less scrutiny by the ATO of that return—that is, that the ATO might have the view that because a tax agent is lodging 10 or 20 returns that they are accurate. That is just a perception that some taxpayers have.

Mr McKenzie—I could not verify that that would be the perception. I can give you an example of a real case scenario.

CHAIR—That would be helpful.

Mr McKenzie—Some time ago, I picked up two individual taxpayers.

CHAIR—From another tax agent?

Mr McKenzie—Yes. They were receiving WorkCover income, which is income not from personal exertion. The prior tax agent had been claiming travel for them for going to the doctor and all of that. That travel was already reimbursed by the WorkCover Authority. I checked with the ATO and the relevant legislation and it is just not deductible. As a result, I lost those clients. They went to another tax agent who was prepared to do the returns. When you have a taxpayer claiming 4,999 or 5,000 kilometres, that can be about, say, a $1,500 to $3,000 deduction, depending on the cc capacity of their car. If they are on WorkCover for five years, multiply that by, say, a $3,000 deduction over five years, that is $15,000 in illegal deductions.

CHAIR—In that case they would know they are doing the wrong thing, wouldn't they? They would know that claiming that, even before going to a tax agent, is wrong because it is not a question of a work expense. You are saying they have already been paid for the travel.

Mr McKenzie—They had been reimbursed by WorkCover in this situation, yes.

CHAIR—And they know that.

Mr McKenzie—Hypothetically, we can assume they knew it was illegal and have gone to another tax agent to do that, that is correct. But we do not know what the tax agent told the client either. How could we improve the situation, which I have heard today, where the onus is on the taxpayer or the tax agent? With the finance services reform legislation they have made it harder for financial planners to do some things. Maybe the tax office or the government could bring in some sort of system whereby tax agents were made to do more paperwork regarding the advice they give and decisions they make when preparing returns. One of the other problems, and I have experienced this, is franchise type tax preparers. Some of those people who prepare tax returns have only done a six-week course. To learn a lot about tax legislation takes a long time, not six weeks. I have seen it first hand. For example, a client of mine left me. He was receiving disability support pension, which is tax-exempt income. He went to a tax franchise type agent to get his return done. They said it was assessable income and that he had to pay tax. He knew that was wrong so he had to come back. That is an example of the training—

CHAIR—And the mistakes that can occur.

Mr McKenzie—Again, the problem is that some of the owners of these tax franchises do not belong to accounting bodies. In the quality review process by the accounting organisation they do not do an integrity and ethical check of what the tax agent does with the taxpayer.

CHAIR—I do not necessarily disagree with you or seek to imply that that is not a problem, or a big problem, but, to play devil's advocate, we do not want to lose sight of the fact that there is an element of personal responsibility and 'buyer beware' in all of this in a democratic society. You can go to anyone from a suburban accountant up to a major accountant, and you know that if you go to a major firm you will be paying a lot. It is the same if you get your car fixed: you can get it fixed by someone in their backyard or by someone who will charge you a whole lot more. That is a concept that most Australians relate to, and it is the same with everything, really. So, whilst I am sure that that is the case, I would not want to see a situation where this committee was saying, 'There is no responsibility or reciprocal responsibility on behalf of taxpayers.' How would you respond to that?

Mr McKenzie—Taxpayers have to wear the responsibilities just as much as tax agents.

CHAIR—That is what I mean.

Mr McKenzie—Perhaps the Tax Agents Board with regard to section 251 could bring in a points licensing system as there is with drivers licences: you lose demerit points where it has been proven that you have committed misconduct or made an illegal entry in a tax return or something. I do not think there is any correlation between the cost for the taxpayer to have the return prepared and the refund or deduction that the client gets.

Senator WATSON—Thank you. You have brought a different perspective to the committee.

CHAIR—Yes. I would not mind fleshing out your supplementary submission, because you made a very good point. For the members and senators who were not here, essentially the submission was about the confusion that arises whereby people think they only have to keep

records for five years, which is the general rule, but when it relates to capital gains tax it is not the case, because you need the records for the life of the asset. I want you to elaborate a bit on that, because anecdotally it is something that becomes a big problem. People have this five-year rule in their head. For example, retirees who are selling a holiday home they have had for 20 or 30 years, and all of a sudden when they go to do that they either make an error or, if they are informed of the law as it is, have all sorts of problems trying to get the documentation that they have not kept.

Mr McKenzie—It is certainly a valid point. I have experienced that with capital gains transactions in the last three or four years where clients have sold their farm, business or rental property. On the plane coming here today, I asked the man sitting next to me, 'How long do you have to keep your records for?' He answered: 'Five years.' I said, 'What if you bought a rental property in 1993 and sold it in 2007? How would I know the cost base or the price of the asset that you purchased if you've thrown your records out?' And he said, 'Oh.' The problem is that lawyers destroy their records after five or seven years too. In some cases the taxpayer has to make an assumption or elect a cost base price for their records, or sometimes we rely on a rates notice, a contract of sale or some other method. The problem is that people think it is five years. There needs to be an education campaign by the ATO and the government to the general public about issues like that.

Senator WATSON—Do you insist that your clients keep an asset register when they have assets they have of a capital nature, which would obviously show the date of purchase, any additions and any reductions in the value for some reason, such as a capital return in the event of a share?

Mr McKenzie—We do not keep—

Senator WATSON—You might not keep one; do you insist that your clients keep one?

Mr McKenzie—Most clients do not keep asset registers.

Senator WATSON—What do you say to a client who does not keep an asset register?

Mr McKenzie—They do not want to comply. There is too much paperwork. Probably one of the most common comments that you get from many taxpayers is: 'I couldn't be bothered. I didn't know that I had to do it. I never got around to it.'

Senator WATSON—They are going to have a huge capital gains tax bill, aren't they? If you cannot establish your cost base you cannot establish, for example, what you paid for your shares. You will be assessable on the whole amount as a consequence.

Mr McKenzie—You can find out what the cost base is from the share registry for that holding.

CHAIR—To take Senator Watson's point, look at property. Property is probably a better example than the more complex one. Finding out the value of the property and the rates notices and those sorts of things, whilst cumbersome, is very doable. What is not is some of the legitimate expenses that you may have encountered over a 20-year period.

Senator WATSON—But your rates notice does not give an indication of the price that you paid for your property.

CHAIR—Exactly.

Senator WATSON—The tax office would not accept a rates notice as a valuation.

CHAIR—No.

Mr McKenzie—There are other means. You could get a registered valuer.

CHAIR—Say you have expended things on the improvement of the property over the period. You would not necessarily have kept records of those but in some way they might be taken into account.

Mr McKenzie—If the issue gets too contentious you can always seek the advice of the ATO about what they can do.

Senator WATSON—What does the ATO tell you in these circumstances?

Mr McKenzie—I have not had any serious circumstances like that myself, but I can verify that taxpayers do not keep their records. One of the contentious issues at the moment is water trading rights prior to marketable water trading. There is no cost price for some of the water. Sometimes these problems arise because lawyers do not do the contract of sale or the contract of purchase. The lawyers do not itemise or do not get a market valuation done at the time of the purchase of the property and things like that.

CHAIR—Another example might be—and Senator Watson, being more of an expert on tax law than me, might also like this—motor vehicles. Whilst people commonly claim depreciation on motor vehicles and these days tend to only keep them through a lease for a few years, it is the case that, if you are deducting work expenses on a motor vehicle over a longer period of time, when you come to sell that car in 10 years time you will have to have kept records. Again, the five-year thing might cause a problem. Is that right?

Mr McKenzie—In that situation, for the accountant preparing the financial reports the cost price should be in the depreciation schedule.

CHAIR—The whole way.

Mr McKenzie—Yes. From the original date and everything.

CHAIR—So that would not apply.

Mr McKenzie—No.

Senator WATSON—You would have to go back 10 years, but they do not keep their records for 10 years.

CHAIR—A lot of people still do not know that.

Mr McKenzie—No, you would not, because the depreciation schedules roll over.

Senator WATSON—I would suggest that after 10 years a motor vehicle would be written off anyway, so the whole amount that you are receiving would be assessable.

CHAIR—But the problem is—and this is where there is ignorance—that that is the case at that point, but if the car is written down to zero over 10 years and is sold for $5,000 or $6,000 that is taxable, isn't it?

Mr McKenzie—That is right.

CHAIR—A lot of people are not aware of that.

Mr McKenzie—That does happen.

CHAIR—I am sure it happens a lot. Thank you very much. As I said before you came to the table, I know you got up halfway through the night to come here from Shepparton. We really do appreciate you doing that.

Senator WATSON—Can we pay the witness's expenses? Can we negotiate that?

CHAIR—That is a matter for discussion with the committee.

Senator WATSON—We do appreciate people coming from regional Australia. We do not want to hear from the big end of town all the time.

CHAIR—That is right, and we cannot go to every regional town. The committee might discuss that with you.

Senator WATSON—Meet afterwards with the committee secretariat.

CHAIR—They might be able to assist.

Mr McKenzie—All right.

Senator WATSON—We have a schedule.

CHAIR—If they do that, of course, your trip today will not be tax-deductible! I will leave that to you. Thank you. We do appreciate it. You said you would be happy to give us some examples of a general nature. You could do that by way of another supplementary submission. We will certainly take all that into account.

Mr McKenzie—Yes.

CHAIR—Thank you very much.

Mr McKenzie—Thanks for having me here.

Proceedings suspended from 1.10 pm to 2.07 pm

CANTAMESSA, Ms Susan Patricia, Tax Consultant, Institute of Chartered Accountants in Australia

NOROOZI, Mr Ali, Tax Counsel, Institute of Chartered Accountants in Australia

DIRKIS, Dr Michael James, Senior Tax Counsel, Taxation Institute of Australia

MILLS, Mr Andrew, President, Taxation Institute of Australia

CHAIR—On behalf of the committee, I welcome all of you here. Thank you for agreeing to give your submissions and your evidence concurrently; that will avoid repetition on our part and it will make for a better hearing. Would you make an opening statement on behalf of each of your organisations? We have your written submissions.

Mr Noroozi—With some of the issues we have raised and some of the issues under consideration it may be a little premature to comment on, only because things like ROSA are yet to be fully implemented, fully bedded down. So one does not want to be too critical before that has happened. But there are obviously issues we can still raise, which we have done. We will be happy to take questions. I wanted to say that up front.

CHAIR—There is one thing I should have said at the outset that relates to all witnesses, but I think particularly to both of your organisations. Throughout this inquiry, which will go on for some months, if you are minded to make additional submissions we would welcome those automatically. So, today, if there are some questions that you do not immediately have the answers to but you would like to reflect on and put in an additional submission, that would be most welcome and of assistance to us. Of course, as the public debate itself evolves over the weeks and months ahead, if there is something you would like to add by way of a submission or there is something you would like to contest that other witnesses say in the coming days and months, please feel free to do so. That would certainly help our inquiry. I did not want you to feel that you only had the chance to put in a submission on your appearance today. Mr Mills, I invite you to make an opening statement.

Mr Mills—The Taxation Institute of Australia represents the interests of over 11,000 practising tax professionals from the accounting and legal professions. I should add that about 250 of our members are from the tax office itself and some of them serve on our committees. It is a core interest of the tax institute that the tax system is efficient and effective and that it imposes minimal compliance burdens on the community. That is the thrust of our submission in many ways. We are all participants in the tax system in some way or another, whether as legislators, administrators, advisers or taxpayers.

In our submission we have made a number of recommendations, and the statement that I am going to make in support of the submission is intended to provide some practical examples of what we have spoken about in the submission. We have noted in our submission, as a preface, that the administration of the tax office is somewhat wider than income tax legislation and some of the things we raise here can apply equally to other self-assessment systems such as FBT and GST.

In the context of the first term of reference in relation to the interaction between self-assessment and complex legislation and rulings, it is perhaps worth reminding ourselves of Jean Baptiste Colbert's famous saying, over 250 years ago, about 'plucking the goose as to obtain the largest possible amount of feathers with the smallest amount of hissing'. If I were to replace 'hissing' with 'compliance costs', I think we would see how relevant that comment still is today.

On one hand, it is appropriate to have laws that, as much as possible, minimise the cost of that compliance. On the other hand, one has to query: is it appropriate to have laws that have been criticised by the courts as being horrendously complex and beyond the comprehension of the ordinary taxpayer? I do not point the finger at anyone in particular because all of us are in fact guilty parties in allowing the laws to get to that kind of level in some areas. We cannot expect people to comply when it can be nigh impossible to understand the law, and it makes a mockery of the principle that ignorance of the law is no excuse.

In terms of the application of common standards of practice by the ATO, we acknowledge first and foremost that the ATO has tried to employ processes across all its employees, wherever situated, to ensure consistency of the application of laws. Nonetheless, we have reports of situations where ATO officers simply lack relevant understanding of, say, a particular industry to apply the law appropriately to the facts. Unfortunately, that is sometimes the case even after those members of the tax office have been working in that particular industry for some time.

A number of issues in relation to the private binding ruling system create some cost to the taxpayer. Firstly, given internal processes, many taxpayers, particularly small business and individuals, find the private ruling process too expensive and time consuming. While the tax office does not impose a charge, the cost of getting a ruling application properly submitted to the tax office obviously has to be borne. Those with more resources to pursue rulings often find the time frames run for months rather than weeks and, while that can often be a reflection of the complexity of the law and the issues they are bringing to the tax office, it is often made worse by approaches within the ATO of some officers, not all, who do not consider it appropriate to advise taxpayers where there are problems with the ruling request or with the structure of the transaction that they have put to the tax office. There needs to be more of a dialogue style approach to dealing with private rulings so that taxpayers are engaged throughout the process.

Additionally, there are instances where the taxpayer fails to get certainty. Again, we have reports of issues that have been the subject of audits by the ATO in years gone by, the positions adopted in relation to particular ongoing activities have been ultimately accepted by that tax office audit team and, years later, another audit team revisits those same issues and comes to different conclusions. That causes great cost to the taxpayer in having to convince those new auditors of things that the tax office had previously accepted. In the meantime, the taxpayer has continued with their affairs on the basis of the original decision of the tax office. If the new position is finally upheld then the taxpayer will suffer significant interest and potentially penalties, and that, in our view, is tantamount to entrapment.

In relation to the operation and administration of PAYG, we acknowledge that some improvements have been made in this area. It is perhaps somewhat instructive that when parliament replaced provisional tax with PAYG instalments it had in part an objective of collecting tax on a much more accurate basis, to the equal advantage of the revenue and taxpayers. The provisional tax system was substantially a real-time system already. It is

instructive that it has been necessary to actually revert to a provisional tax style uplift for some taxpayers to alleviate some of the compliance burdens that are imposed by the PAYG instalment system. Unfortunately, that is not sufficient to alleviate the cash flow issues for many small businesses who do not fall within that carve-out that are entitled to make use of the provisional uplift. It serves as a lesson to us all in introducing new systems: we have to be aware of the compliance burdens we impose on taxpayers. So now we have got a system that has features of both provisional tax and PAYG. In retrospect, the old system substantially worked and maybe we could have achieved the same result with a few changes to that, rather than throwing out the baby with the bathwater.

While on the topic of changes to law, it is our view that parliament needs to recognise that taxpayers audit their affairs according to the law, or at least most compliant taxpayers do. The interpretation of that law by the ATO and the final arbitration by the courts are what guide taxpayers. For parliament to make retrospective changes, it has the practice to do so only where there is significant anti-avoidance and, even then, only from the date of announcement by the relevant minister. The recent practice of amending the law with effect back to a time much earlier than such an announcement is to undermine the rule of law.

On other administrative issues, there are questions around contentious interpretations. It is our view that where the ATO maintain a contentious position that is at odds with decisions of the courts, taxpayers should be given the benefit of the most favourable position. The ATO should acknowledge that its view is at odds with the law and ensure no penalties or interest is imposed if the law is ultimately found to be different. Thank you, Mr Chairman.

CHAIR—Thank you. What I propose is for us to discuss and question your submissions, but if a question is directed to you, Mr Mills, and the institute has a perspective, please feel free and jump in at the end of the answer to put your perspective, whether that is one of agreement or difference or a different perspective, so that the discussion is not weighted against either of your organisations.

Senator WATSON—Thank you, Mr Mills, that was an interesting but somewhat disturbing presentation. Could you provide the committee in due course with a number of those cases where the judiciary have been critical of the laws that they have had to interpret?

Mr Mills—Yes, certainly.

Senator WATSON—I think that would be useful for our record. Today in the *Financial Review*, as part of the taxpayers charter, generally it was considered that the written advice from the tax office was often unclear, that it could be a lot better. You might recall reading the article. Is that your experience—that they tend to rely too much on jargon? Maybe you can understand the jargon.

Mr Mills—As a practitioner who often deals with the larger end of town, I am probably more used to the jargon and not in the best position to judge. I think it is better to put ordinary taxpayers in front of that question, because the nature of the tax system for those involved often becomes a bit difficult. On the other hand, I guess there are instances—and there will always be instances—where letters can perhaps be confusing, misleading or incomplete, but I do not think that the tax office need necessarily be singled out.

Mr Noroozi—The reality is that the tax office is a very large organisation. Sometimes it has to send out similar letters to a large group of people, as a result of which I think it has a challenge in trying to deal with things efficiently but at the same time have things that are sufficiently suited to a particular taxpayer when they receive it. We heard from the new commissioner that he has this letter improvement project still going, and I understand the tax office is working on improving that.

I think also in the *Financial Review* there were general issues raised about advice from the ATO, not just through letters but even through the phone. We run a bugbear survey—and I think last year's is attached to our submission—and that is always one that comes up, that people find it hard when they ring up the tax office to speak to an expert to try to get their issues resolved. In other words, you may be put through to a number of different people and you may eventually end up talking to somebody who can address your issues, or people may ring up and get different answers depending upon whom they talk to.

Senator WATSON—That is a worry.

Mr Noroozi—That is something that you will see in the attachment to our submission. It is called the bugbear survey, and that issue has come through. However, I do think things have improved and it is something that the tax office is still working on. But it is a challenge. We also run a query line at the institute, and I can sympathise with the ATO. When you have people ringing in, particularly with complex tax issues, it is difficult to be able to give somebody an answer straightaway.

CHAIR—And they are not ringing because it is a simple matter.

Mr Noroozi—Some of them can be. Some of them may be from the small end and feel that, if they talk to somebody who does audit in this area and the like, they might be able to answer it almost straightaway. But I think it takes time and these are the challenges for the tax office. I think they are taking steps to improve it, and we are working with them to try to improve it. For example, we have the new bugbear survey, which we are presenting to the ATO tax practitioner forum on 4 August. They do genuinely try to overcome these issues but, yes, you are right: we still do get some instances of our members having problems with getting the kind of advice that they can work with.

Dr Dirkis—Building on that, I think there are concerns about the level at which requests are made. Essentially, with the majority of telephone inquiries that non-professional taxpayers will try to engage in, they will hit a call centre where somebody is reading from a script. Depending on their experience, they may be wise enough to ask the right questions to cut through but, because you are operating at very much that level—

CHAIR—If they ask a clarifying question, they just get the script read to them again.

Dr Dirkis—Yes. The difficulty is that in many cases the script also reflects what is already on the website. So if you have a proactive taxpayer who goes to the website and does some initial inquiry—

CHAIR—And if that does not answer it for them—

Dr Dirkis—Yes. It is a bit about how far you can advance a question before it then needs to be put into some degree of writing. The difficulty is that those processes often take a longer time. Even from the professional viewpoint, in some cases you just need someone with a higher level of experience to ask the right question to work out what is really the problem. In one sense, it is the nature of a large organisation trying to service a whole range of inquiries. A lot of the inquiries are simply: 'Where's my refund?' and that is fine. But once you start moving beyond that, the tax office is faced with that difficulty of how much information do you give and at what level do you employ people with suitable qualifications to give that advice.

Senator WATSON—Should the tax office be employing higher skilled people at their call centres? If they had a very much higher skill level than people who are forced to just read from a script—

CHAIR—Or at least a room they could go to.

Senator WATSON—there would be more chance of them being able to comprehend the difficulty behind the inquiry.

Mr Noroozi—This is the challenge, you see. I do not think you necessarily want an expert to be the first port of call, but that is almost what you need because the person needs to have some appreciation of the problem before they can actually put the person through to the right channel. These are the challenges, I think. You can understand why the ATO might have difficulties with it, but at the same time you can understand the frustration on the tax agent's and the taxpayer's side.

Senator WATSON—While they have these unqualified people reading from scripts, we are not going to improve the situation.

Mr Mills—They have gone some of the way, to be fair to them, by using what they call fast keys for tax agents, which is, you know, 'Press the right buttons to get through to the right people.' But I agree on the inexperience. It reminds me of this. I worked in the tax office for a number of years, before leaving in the 1980s. If you went through the assessing area—which does not exist anymore, of course; we now have self-assessment—you spent some of your time answering the questions on the phones. So there was a level of experience and understanding of the tax law in the people who were actually doing the doing, if you like, and responding. Unfortunately, it seems we do not have the ability anymore to move people in and out of answering those kinds of questions. There obviously need to be improvements to direct questions to the right people.

CHAIR—Ms Cantamessa, you were about to make a point.

Ms Cantamessa—I was going to say that the problem that arises when you have taxpayers or tax agents calling the tax office is that they get very frustrated at getting that first call by someone who does not appreciate the problem fully, and they can oftentimes get bounced around to quite a number of people within the tax office. I do not know that there is an easy solution.

CHAIR—They then ring their local member of parliament!

Ms Cantamessa—Do they? I go back probably to the old days where, when you rang the tax office, you could find someone to actually speak to regarding a particular issue and get an answer. I am not entirely sure what the solution is.

Dr Dirkis—Tax agents would like to see a return to the old days of what they would call the tax agents liaison centres and where they had a closer relationship with key people within the tax office. Although there was an attempt to address that through the relationship management system, that really has had problems from day one and has not been fulfilling what the tax agents would like. The reality is, I suppose, given that the tax office has followed the banks' lead and moved from having suburban branches with all services to having business lines spread across the country, you can ring up and think you are talking to someone locally but you are actually talking to someone in Perth.

CHAIR—That is a very good analogy, because some of the banks are now reversing that, aren't they?

Mr Noroozi—The relationship managers were supposed to partly do, as Michael referred to, what was done before by the TALCs. That is again something that in our bugbear survey comes out fairly highly. They find that, with a relationship manager, there are two problems. One is with their technical knowledge and the second is with them having enough clout to actually make things happen within the tax office. If you are experiencing a problem, they are not always able to escalate it or make sure something does happen about it. I think the tax office is reviewing that whole relationship manager situation. We have the same experience: as Michael said, TALC is something the tax agent would happily go back to.

Dr Dirkis—Part of the problem also is—and this is reflecting on the change in the organisation—that there are now so many accountabilities and requirements imposed upon officers within the tax office that, if you talk to officers who operated within the system 10 or 15 years ago, the level at which they had discretion or the level at which they could give advice or make decisions was far higher than it is now for even senior officers. They are often confined by their obligations to where they work and what they do, and many tasks have to be referred. You need to try and seek some balance within those accountabilities.

Certainly there are very positive noises coming out of the new commissioner about looking at the advice area. It certainly featured at the National Tax Liaison Group's last meeting. The commissioner talked about the need to address the whole issue of getting advice and how best to do that. It is certainly on the tax office's radar but obviously it is not currently where most people would like it.

Senator WATSON—Before the hearing commenced, we were talking about complex laws which were essentially drafted for the big end of town—grouping provisions and these sorts of things. But the real problem seems to be when those complex laws get pulled in and have an impact on small and medium businesses. Would you like to put something on the record as to that?

Mr Mills—Yes, thank you. I think that is absolutely correct insofar as such developments of things like the taxation of financial arrangements. The draft legislation that we saw last year was very wide in scope and many submissions were made on the basis of the width of the scope of

that proposed legislation. It is instructive to go back to the whole reason for having a taxation of financial arrangements regime. That was that there were very large taxpayers who had difficulty matching their accounting requirements with the tax requirements and were having to make quite a number of difficult adjustments at a practical level, so the ability to align accounts and tax made a lot of sense. Even though it actually meant they recognised a potential bring forward of tax, they were prepared to pay for the simplification that it brought. Unfortunately, the drafting of the legislation is not just targeted at those kinds of instances; rather, it is much more broadly drafted to cover individuals and even small businesses. Although there are carve-outs, the carve-outs are not comprehensive and people will still be caught. Another example of the taxation of financial arrangements, TOFA, regimes that have already been introduced is the foreign exchange rules, which are very complex, and I suspect they are being honoured in their breach by small taxpayers.

Mr Noroozi—I think that at least with taxation of financial arrangements stages 3 and 4 they have envisaged a carve-out for small business. But perhaps a more illustrative one is the consolidation regime. At the time there was quite a lot of talk about having a carve-out for small business. But, as you can see, we have ended up with problematic legislation which the big end of town, let alone the small end, is having a problem with. We have a plethora of rulings and determinations trying to clarify it. I think that maybe the consultation around that could have been improved, but certainly a carve-out in that scenario would have been useful.

Although there is complexity, I sometimes sympathise with the Treasury. Sometimes you are dealing with very complex transactions and naturally the laws relating to those can sometimes be complex. But some of the complexity may be able to be avoided—or at least the compliance nature of it can be avoided—if we were to actually pay more attention at the time of the design of the legislation. Again, we have not included any of this in our submission because we thought this was more to do with administrative, rather than legislative, matters.

If only at the time people like us could provide input—as well as Treasury—so that they would be aware of the compliance impacts on taxpayers. I think there is some work being done on that and that that is improving. There is, for example, in the design ethos of Treasury something like road testing and post-implementation reviews. Oftentimes these do not actually take place. We have had a few post-implementation reviews done by the Board of Taxation but sometimes some of these problems do not actually come to the fore until legislation has been in place for a little while. I think these post-implementation reviews are very important. I also think road testing is quite important. But with some of that we are to blame for that too because sometimes we are so desperate for a measure to go through that, in our eagerness to have some good measures introduced, we miss things. So I think those are some of the things that we should perhaps work on more in the future. But, as I say, we limited our submission purely to administrative matters.

Mr Mills—I would like to speak in support.

Senator WATSON—It is fairly evident that some of the criticism that is levelled at the Taxation Office should really be redirected back to the parliament itself. Cases that you have mentioned, where the laws are very difficult and uncertain, are a legislative problem rather than a tax office problem.

Mr Mills—It is; however, the legislation that is presented to parliament is often a result of the work that Ali was referring to, which is a consultation process that involves us as much as it does Treasury. I think we do not spend enough time going back and thinking about the laws that have already been introduced. I have often quoted the example that our capital gains tax legislation is some 400 pages long, and there are lots of reasons for rollovers, special concessions and so on that have been granted that take up about half of that. But I still scratch my head about why it takes 200 pages to say, 'If you make a capital gain it is included in your assessable income.' It is fairly basic concept. The beauty of saying things simply, of course, is that it allows the courts to get the right result, it allows taxpayers not to muck around with having to understand a whole lot of detailed legislation and it allows the commission a level of flexibility to also get the right result. It is a much more sensible way of drafting legislation.

Senator HUMPHRIES—You refer to the problem of the fringe benefits tax and the double taxation issue that is in our terms of reference. We have not discussed that very much in this committee so far, but your suggestion is fairly simple: that we should transfer the liability for that tax from employers to employees. That certainly has a great deal of directness and simplicity about it, but it also strikes me as being rather a courageous step, in the *Yes, Minister* sense. Would you suggest that at the same time there would have to be other adjustments to the taxation regime to effect that?

Mr Mills—One of the greatest bugbears of the fringe benefits tax system is that it is, again, drafted very broadly; it catches everything and then we have a number of exemptions. I should point out that there is often a fringe benefit reporting requirement on group certificates anyway, so we are picking up benefits provided to individuals, which is what the fringe benefits tax is all about, and sticking it on group certificates for social security and other purposes. And if we were to simply continue with that approach and say, 'We're picking up the important ones that relate to the particular individual who is getting the benefit; why do we need the rest of the legislation?' then it would actually be a step in legislative simplicity as well. In addition, with the changes in the tax rate, there have been considerable moves at a couple of stages over the last five years to ensure that 80 per cent to 85 per cent of taxpayers are paying no more than 30 per cent tax. At the moment there is quite a distinction between that rate and the 46½ per cent rate that now applies to fringe benefits in the hands of the employers. That is disproportionate.

Mr Noroozi—While we have not mentioned it here, we did commission Atax on this very point and they came up with that conclusion as well. The fringe benefits tax came in in the eighties, and I think it was a result of the political process that it ended up being taxed in the hands of the employer. There are problems with that, because you are taxing the person who is not actually legally receiving the benefit. There is an enormous amount of complexity as a result of that. But even the scenario that you mentioned, which was in the TI—and we can also send you the Atax report on fringe benefits tax that has the same finding—has some complexity. It needs to be thought through. We have encouraged the government to look into reform of the fringe benefits tax. What the government has done as a result of the banks review has lifted some thresholds, so it has provided some releasing of the pressure valve; but there is major surgery needed with FBT and I think the consultation process needs to begin. That Atax paper I referred to basically canvasses a number of options. I think the options mentioned there are the Irish and the New Zealand models. We end up talking about the Irish one, the UK one being a bit older and there being some differences. If you want to cut down compliance costs, FBT is an area that affects small businesses and large businesses and is an area that needs reform. I cannot say that it

needs it more than any other area, because there are so many areas that need reform. But it is a major area that requires reform to cut down the compliance burden.

Dr Dirkis—Part of the difficulty with fringe benefits is that it is probably another rule that at the small business level is honoured in the breach. The New Zealand model, as originally designed, was quite simple. They asked: 'Where are 90 per cent of the fringe benefits arising?' They then said: 'Let's go after that. Let's make it very specific. They're the bits that we want to tax, and by hitting the employers we'll try and encourage them to cash it out.' That is essentially what the driver was under the original fringe benefit tax rules. The difficulty is that our approach was to go global, as Andrew mentioned, and to try and capture everything within the web and then only let little bits out.

By doing that, we have created all these very complex rules. For example, if you are within a car park, within a certain distance there is a certain price that you have to work out. If you look at the liaison meetings with the tax office and the profession over the almost 20 years of FBT, car parking appears on the agenda of every single meeting. We have really got to the point where we need to ask: 'Where are the big dollars in this stuff? What are the things that we want to chase? Are the little ones really worth it from the collection side?' We need to narrow the focus of it. Then it becomes more plausible to deliver it back to individuals, because you are asking them to do it in fewer circumstances.

Senator WATSON—You could have that system and, like capital gains tax, within the tax return have a different tax rate that applies to fringe benefits. You could have that as a 30 per cent or lower rate—30 per cent would be an injustice for someone on a 20 per cent income tax rate—to ensure that there is a standardisation.

Mr Noroozi—If it was treated, as we have suggested and as is suggested in the Atax report—

CHAIR—It would be 30 per cent or 15 per cent.

Mr Noroozi—What we would suggest is that if it was done through personal withholding it would be very easy for it to be still taxed at the marginal rates, because it would be benefits in kind. In the UK, they effectively tax it as salary and wages. One of the complexities that I referred to and that needs to be looked it is what you do at the end of the year. You do not know about some of these benefits until the end of the year when you work it all out. In the New Zealand model, the employer does all of that and there are very complex calculations that have to be done. What we suggest is that that should be a reconciliation that the employee does when they lodge their tax return. To the extent that they have received additional fringe benefits, they should declare that when they do their tax return. None of these are perfect solutions, and that is why I am suggesting that there needs to commence a consultation on fringe benefits tax so that we can drill down to all the issues.

CHAIR—The point about consultation—

Senator WATSON—Perhaps you could give us a submission on aspects of the Irish vis-a-vis the—

Mr Noroozi—We can send you ours—

Senator WATSON—I think that could be useful.

Senator HUMPHRIES—I have one quick question. You mentioned the staff attitudes in the tax office and how they have not been conducive to negotiation or dialogue. Do you think that is a question of the training of the staff there or is it a question of the culture of the place? Should there be rulings of some sort internally that sort that out? What is the solution to that problem?

Mr Mills—There are many cultures, like in any large organisation. We are getting very good vibes from the new commissioner and his immediate reports. The people who we deal with at that level are certainly talking the talk. We find that lower down at the practical level certain parts of the tax office—the audit division, for example—have a particular culture that reflects protecting the revenue. It is not completely unnatural; it is to be expected in some ways. But sometimes they pursue things—and they turn up in the courts from time to time—because they perceive some mischief that is not really there at all. That requires a greater understanding and perhaps a pressure brought to bear on those people to think of the bigger picture, to understand that tax was paid and paid at the right rate in those circumstances, so that when they lose the case they are not surprised. I have seen examples of that. There is more than one culture.

Senator MURRAY—I will preface my way remarks this way, because I have heard some comments about the eighties, nineties and all that: in the last 10 years, perhaps a little longer, more legislation has been passed than in the previous 90 years. It is an absolutely different environment, and it is almost impossible, I think, to demand of any tax officer the ability to cope individually with the queries and so on that arise from that. In my own capacity, over the last 10 years I have dealt with every single piece of tax legislation that has come before the parliament personally, as a portfolio holder. I will describe to you that my common feeling is one of absolute helplessness. You are helpless, and you can see by the minister's face that he or she is helpless; everybody feels helpless. There was a problem, a solution was arrived at, a consultation occurred and they produced this legislation. Invariably you know that this will make things more complex and more difficult and yet you feel helpless in the face of it.

With that background it is time for all of us—because no-one has clean hands—to say, 'We've got to stop this and we've got to make the system work better and be simpler and easier to use; how do you do that?' I want to ask a question with respect to the consultation process. Once legislation is designed and gets to parliament, it is essentially a numbers game and it is shoved through. Before it gets there, there is not a process—let us use an example you have just used, say FBT or CGT, and say: 'Does this legislation actually make CGT or FBT work better and more simply? Do we have a better act as a result and why?' I do not think that occurs at all in our process at present. I want to know where you feel the shortcomings in consultation sit at the moment with respect to the final outcome.

Mr Noroozi—One of the problems is maybe even a bit earlier in the piece. We do not get consulted at the pre-policy setting stage, so by the time we get involved the policy has already been set. We then have to see whether that policy is correctly implemented. Sometimes it might be that the issue might be earlier on, but we do not get an input there. Also, at the Treasury stage, as I mentioned, we do get involved. They seek our comments and we provide comments, but some of those are taken into account and some of them are not. The end result we see is that Treasury has taken into account what we have said and they come up with a solution. As I said earlier, the other problems are that perhaps we all need to be more aware of the compliance

issues, we need to carry out some road testing and we need to do post-implementation reviews. But I think that probably the most important one is that pre-policy setting stage, because once the policy is set your hands are a bit tied. For example, one of the things that were introduced last year, which I know you spoke of in the Senate, was the loss recoupment measure and the introduction of a $100 million ceiling on whether you can pass the same business test. We do not believe that that measure was properly thought through. The policy behind it is not clear. A review was then ordered of how they can improve the same business test. As I say, sometimes you almost need to go a couple of steps back to the policy setting stage to make sure that what follows is appropriate.

Senator MURRAY—I do not see anywhere in our system a quality control process that is respected, independent of self-interest and of the political world and simply says, 'Will the new act, as it is going to be after the passage of the changes, be better than the previous act, and why?'

Mr Noroozi—It is the board of tax.

Senator MURRAY—But that is long after. The board of tax tends to come into play when the act has been around for a while and the problems are being exposed.

Mr Mills—I agree wholeheartedly. We all stand accused of not going through that process personally. Nor is there a systemic response to exactly what you are talking about. As an organisation, the taxation institute has been looking at that particular issue. That is probably exemplified by some of the things I have said so far today. We commissioned a report for the simplification of the tax act, going beyond the 4,100 pages of redundant legislation and legislation that can be improved. I agree with Ali in terms of the policy setting and trying to ensure that we are involved in that.

At an earlier stage ministers often come out and make a statement about a change to the tax law and then give a whole lot of detail in relation to it, rather than saying, 'Hang on. The principle or the response to a problem that we are trying to achieve is X. Let us then announce that and go away.' Governments are elected to implement their policies. That is their responsibility and that is what they are responsible to the electorate for, at the end of the day. Nonetheless, we are talking about the detail of the policies and the words that are put down in legislation that people then have to deal with. I am happy to table the report that we did and leave a copy for the committee, but I agree wholeheartedly. The kind of review that you are talking about is perhaps in other jurisdictions, such as the US, done by Congress itself.

Senator MURRAY—I want to ask whether your two organisations might consider—and I will repeat what I have said elsewhere: you do not have to—coming back to us with some further ideas on the quality control measure. The executive has measures whereby it tries to control the process. You might decide something should be revenue neutral, so if it is not revenue neutral, it will not go. Or you might decide it cannot be retrospective, so if it is retrospective, it does not go. You see those sorts of threshold measures. I do not see that in the introduction of legislation which addresses a problem that there are any of those sorts of measures which say, 'All right. If this is more complex, harder to interpret, will generate more questions from taxpayers and produce greater compliance costs, we are just not going to pass it. We will leave the law as it is, with all its problems.' There is none of that process. The problem

with the parliamentary process, even where a Senate committee or a House committee may consider the legislation, is that because the executive has already committed to that legislation you cannot shift its boundaries.

Mr Noroozi—You are absolutely right. I know that a few months ago the Board of Taxation took a trip to New Zealand, because their consultation model is apparently quite good. One of the issues and reasons why they are able to have consultation right from the beginning to the end—in other words, at the pre policy-setting stage—is that the way they deal with tax issues is generally bipartisan. Things are much more out in the open. The consultation is much more out in the open, so they can consult with people at the pre policy stage. I do not know much about the findings of that but the board of tax could perhaps shed some light on it. I understand they did come back from New Zealand with some recommendations. So it might be worthwhile—

CHAIR—Yes. We are awaiting a copy of that. We will approach the board directly.

Dr Dirkis—We did some research into the Ralph small business concessions and looked at where we ended up. One of the aims of the review of business tax was to ensure that compliance costs were reduced. The feeling from some research I did with Brett Bondfield from the University of Sydney was that as the review went on it became too difficult to deal with small business in an effective way, because you were trying to regulate for all taxpayers through the changes. We have not adopted the sort of scheduler approach in the UK, where you treat different taxpayers with slightly different rules to give rise to their particular outcome.

When we went through that process, we looked at the compliance costs that then arose and what the responses were. The responses from the review committee seemed to be very much along the lines that it had got a little bit difficult so they would give some concessions—some simplified tax concessions, some concessions around retirement and small business rollover. That was the limit of the concessions given. The reality was that a lot of the CGT concessions, which were seen to be the biggest concessions to small business, are all honoured in the terms of people giving up business. You are selling, retiring or leaving. You are not dealing with the fact that a whole range of compliance costs were imposed on small business from the introduction of GST onwards.

When you see the data that certainly Atax and academics have done around small business costs, there are some basic costs coming in at about $2,500 to $3,000 per small business. They are costs that just have to be handed on. The difficulty is that a lot of those are now settled, ongoing costs within the system. We made a number of recommendations around improvements to the statements made to parliament about revenue impact statements and the need to build in also the cost of compliance so that government knows at any point in time when a measure comes forward—that, yes, it is going to raise $20 million but there is also going to be a cost of compliance of $30 million. That may in fact stop people saying, 'We're making a legal statement that we do not want this behaviour, but maybe this behaviour is more costly to stop and we may pass more costs on to the community.'

Mr Mills—There are occasions, to be fair, when professions, industry bodies and so on, have raised exactly those kinds of issues. They have suggested that the solution that has been adopted is a worst-case solution, that there were much more efficacious means of achieving the objective. Whether you agree with surcharge or not is irrelevant. That was the policy of the government.

But the way that it was implemented meant hundreds of millions of dollars of costs to the community in compliance. There were much simpler and recommended ways of going about it that were not palatable for political reasons, so we were told. But that is a classic example of there always being a better way of doing things. Unfortunately, perhaps we are not loud enough in our complaints on that score.

Mr Noroozi—I think if you have a look at the tax design leaflets that Treasury has on its website, they are pretty good. It is a matter of implementing those principles. As I said, sometimes we are also to blame when they are not adhered to, because we also want some measures to come in sooner rather than later. So your point is taken.

Senator MURRAY—My problem is that the tax design measures and guidelines, as I understand them, are focused on the design of whatever remedial or other change you may be putting forward. It does not relate the new bill to the total environment which that bill is going to address. That is my problem. So maybe they are designed coherently—say it is a CGT change for integrity reasons or policy change reasons—but it is not necessarily looked at in terms of the total act as a result. That is my impression. The result of that is there is a weakness. I can give you an example. When a manufacturer produces a product, say, motor car, there are certain things that that motor car must be capable of doing before it would even be considered by the board for the new model. It has to be of a certain characteristic, which includes safety, fuel consumption, efficiency and all though sorts of things, otherwise it does not even pass muster.

Mr Noroozi—That is something that is supposed to take place.

Senator MURRAY—I am not convinced it is happening. So, what we are getting is a product which has not been pre-tested. It is only once it is in operation that significant problems are discovered, and then they try and fix that. Then you are adding onto an imperfect vehicle, to use the analogy, withdrawing it from stock and putting the new model out.

I do not have the solution. I do not even begin to think I have, because I do not. I do not know where to go. Are people like you able to provide us with some guidelines as to whether there should be an automatic stop on any new legislation if it is going to produce great problems for taxpayers?

Mr Mills—I would support that. I am sure that we can come away with some suggestions but we certainly have no silver bullets either. I suggest to you that there is an even bigger problem, and that is when we look at introducing that new car, we don't take away the horse and cart at the same time.

Mr Noroozi—That is right. With some of the international measures, for example, we are all aware that that is part of the ethos, the 'road testing'. We point out as many of the issues as we can but in the real world there are deadlines as to when you can provide your comments. You do the best you can in the time you have, and you point out as many of the issues as you can. There is a certain amount of 'road testing', I think is the terminology used in Treasury, but there is also the requirement for post-implementation to pick up. For example, at the moment there is an international measure for CGT and non-residents. It was a measure not in this year's budget but in the previous year's budget. It was introduced into parliament towards the end of the last sitting. There are international transactions waiting for that measure to go through. Do you wait

until the thing is absolutely perfect and make all these transactions wait? Or if you have done the best you can in terms of due diligence and pointed out as many of the issues as you can and they have picked up a reasonable amount of them, do you not scream too loudly? There are those kinds of balances to be reached.

What you are saying is absolutely right. It should have, for example, been done with the consolidation regime that was introduced. It does not always happen. A lot of the times it is not our fault, but sometimes it is, like I am pointing out with some of these international measures, where people are waiting for it to come out. But you make a very valid point, and it is true.

Senator MURRAY—I ask you to think through this a little, and come back to us. If you can find a way to improve what is a real problem for all of us, it would be helpful.

Mr Mills—There are other examples of integrity measures that are introduced into the law around loans to shareholders, small companies and so on—the division 7A problems—where the cure is worse than the illness. We have got to the stage where we end up taxing things that are just internal re-organisations or bank driven reorganisations of loans and so on that give rise to the application of these rules with no discretion for the Commissioner not to apply them. The horse and cart reference I made is that we introduced imputation without ever going back over the rest of the law and working out whether it should have been altered in more significant and substantial ways as a result.

Mr Noroozi—Some of the complexity also is because, as you say, Treasury wants to make sure they don't miss a cent or a dollar. Sometimes you might have to give up on some of those on both sides if you want to reduce complexity. Again, that is the balance for the government and also for the people providing input, like us, into the consultations. FBT is another classic case. Michael was asking: is it worth it? How much money are you collecting for all this compliance? FBT is a good case in point. If somebody saw not only what it costs the Tax Office but what it costs business to comply with it, they would find that it probably does a lot of damage to the economy.

Senator MURRAY—One of our great problems is we don't have an open process. Governments, and you can understand why, are terrified that they will lose revenue if they are open about what they want to do—if, in other words, they announce it and then they do it. We don't have an open process whereby the draft legislation is put out, there is a proper technical and professional appraisal period on a no-regrets basis. It can then be dealt with in proper time. It is all kept under wraps, down comes the announcement, and then the legislation is pushed through. The result is what we have now, which is an overly complex system.

Mr Mills—Agreed, but the response of governments of both colours over the years has been, 'If we put this out into the open, it will end up on the front page and everyone will complain about this part or that part.'

CHAIR—Not only that. There are certain instances where a tax announcement on budget night from the moment it is announced if it does not take effect will have a behavioural effect. Even Senator Murray, my friend and colleague, would concede that. I think his point is that that excuse has become the norm for so many tax announcements.

Senator MURRAY—There are some that do not need that treatment.

Mr Noroozi—They took a sensible approach on the FBT measures, for example, in this budget, where they did not do it from budget night but they actually did it from the financial year. Even though there is a chance for a few dollars to be made here, they took the right measure. But the super changes, for example, had to happen on budget night. Otherwise it would have left the door open to abuse.

Mr Mills—Having said that, super is also an example of where there are aspects of it that no detailed policy was announced. It is in a process of being worked out in terms of its implementation. But that is a good model insofar as that is concerned.

Senator MURRAY—But it is not an open process.

Mr Mills—No, it is not an open process.

Senator MURRAY—And that is the difficulty.

Mr Noroozi—We would not argue with you on transparency.

Senator WATSON—I was interested in your comments about instalment taxation vis-a-vis the old provisional tax system. You suggested perhaps that the provisional tax system had certain virtues with some modifications over and above what we have now. Is there still time to revert back, with modifications, to the provisional tax system? Is a new system actually raising more or less revenue than the provisional tax system?

Mr Mills—At the end of the day either system will raise exactly the same amount of tax. It is only in both cases a means of paying estimates of what the final tax liability is going to be. What we are concerned about in particular for small business, which is mentioned in our submission, is the fact that people have to collect data and report that and pay their tax in a very short space of time—much shorter than they are required to report to any other agency. Therefore, they default to paying the maximum amount of tax effectively in their instalment and make it up at the end. That causes a cash flow issue quite clearly for small business.

Some taxpayers have been, as I have said, entitled to take the uplift approach. Many taxpayers, rather than doing the calculation, will take the uplift. What I am getting at in making those comments is that the simple system of uplift, although it had problems, at least was simple—you knew exactly where you stood. The PAYG system, although it is trying to be more accurate, is about trying to collect every last red cent as soon as possible in the process rather than saying, 'Maybe there are some timing differences that are going to arise here, but at least we will get more compliance because of greater simplicity.'

Dr Dirkis—And you compound that problem in that it is a collection mechanism every quarter or every month, depending on size, with other areas of the law that will bring forward artificially amounts before people collect them. So, for example, in the area of GST, if you receive a deposit for furniture, you are required to remit GST on the whole value of the order and not just on the amount of the deposit. For a small furniture or appliance retailer, this is a bring-forward of cash, magnifying the problems of the pay as you go. There are a number of examples

as you go through where you start seeing some of these within the other areas of the law. So if you are going to bring forward the reporting, that is fine, but in the end you need to make sure that the other interactions with the law match that so that what you are actually bringing forward, if someone is a cash taxpayer, then they are only ever remitting GST on that basis and not having these things brought forward. So it is a compounding effect that reflects back to Senator Murray's view that we have a measure that we bring in but we then do not look at its effect on the broader parts of the act and where we get inconsistencies between established policies.

Ms Cantamessa—The pay-as-you-go instalment system is probably another one of those examples where we had legislation that was brought in and the effect of it was realised after the event, which is why we almost have this partial reversion to what we had to start with. At the end of the day, now you have a base legislation with so many carve-outs that is extraordinarily complex legislation to read. Something that was basically fairly simple for companies and for individuals is now extraordinarily complicated.

Senator WATSON—Thank you; I think that is very helpful. In 1993 the PAC was interested in the establishment of safe harbour provisions. I should know the answer to this, but has the government really taken on board adequately the need to provide safe harbour provisions to protect taxpayers from unintended outcomes?

Mr Mills—There are examples quite clearly in the law. Thin capitalisation comes to mind where there are safe harbours. Where there are safe harbours though, often they are extraordinarily difficult in their application. Since the introduction of the foreign investment fund provisions—which are very wide reaching, it is just that most taxpayers do not realise it—there are enormous carve-outs, but in order to go through the compliance costs of actually getting through to working out what your carve-out or safe harbour is, is often quite difficult. Do they exist enough? It would be fair to say it is not a regular feature of legislation over the last 10 or 15 years, that safe harbours have not been a common feature by any stretch of the imagination. Perhaps what we have also found is that, at the administration level, the commissioner does not have the power or sometimes feels constrained in providing similar safe harbours for the actual practical application. The service trust ruling was a recent example of that, where the commissioner had to apply the law, as it has been set down by the courts, and that is fine. He gave some guidance as to how he would apply it practically, but he could not give a safe harbour and say, 'You're in this, then I won't annoy you.'

Mr Noroozi—They did not give us a safe harbour as such, but they did say in the service trust ruling what is low and high risk.

Senator WATSON—In my discussions with the tax practitioners, at the end of the day most were relatively happy with the outcome of the service trust. Is that right?

Mr Noroozi—It depends on how you look at it. It took us a long time, and the Inspector-General's review into the ATO's handling of complex matters, one of which was service trusts, will be telling when it comes out. The length of time it took, and why it took so long to arrive at least with something that was liveable, that is a question to be asked. In the end, we worked very closely with the ATO, and we found it a very productive process. But one needs to also ask why it had to reach such a level before we were able to sit around the table and try to come up with a liveable solution. But the most positive thing that the practitioners are relieved about is that in a

majority of cases, at least it will not have retrospective effect. Whether there is a change of the perception by the taxpayers, whether there is at least a perceived change in what the tax office's adopted position post this ruling guideline, most people perceived it to have a retrospective effect, which has been removed for the most part.

Senator WATSON—The public and private rulings, you put a lot of emphasis on that previous report because of the problems of uncertainty of the law, and rulings obviously played a big part of that report. To the credit of the government, changes were made. But from what we have heard today and read recently, public and private rulings are not really working as well as they should be. People complain today about the high cost of the rulings.

Mr Noroozi—That is true. The one positive thing that they have done particularly at the bigger end of town is that they have a special process for complex rulings, but I am not sure if there has been much improvement at the medium to small end of town. That still needs improvement. That is for the private rulings. Again, cutting it short, we have talked in our submission about the public ruling process, and if you refer to our submission we do suggest that perhaps there is some improvement required in terms of the delay and length of time it takes to finalise those rulings.

CHAIR—If you have anything additional to provide to us on that, that would be of assistance.

Senator WATSON—It would certainly be of assistance.

CHAIR—Before we wrap up, does the Taxation Institute have anything to add, especially on Senator Watson's last question?

Mr Mills—In terms of the rulings process, we support what Ali has said. We have the same sorts of concerns about the cost. I am not even sure about the simple improvements to the administration. At the moment, the extremely strong governance obligations on the tax office—and that reflects the way the community has moved—are to such a degree that the costs of doing it are still going to be fairly high.

Dr Dirkis—One of the obligations particularly on small taxpayers is the requirement to spell out your case, for example. Now that is quite correct, but then there is the requirement, even if they go to a tax agent and they are not paying a great deal of money for that service, for them to spell out in some detail what the legal position is. In some cases what people are really wanting from a ruling is: 'Here are my circumstances. Am I okay?' and not having to say: 'Here are my circumstances. I believe that under section 8-1 I am entitled to whatever.' That is part of the difficulty with the costs—the current requirements, particularly at the smaller end, require them to invest a great deal of time and a great deal of knowledge, which most people do not have.

Mr Noroozi—The other thing they also complain about is the requests for information. They sometimes scratch their heads and wonder what the relevance is of the extra piece of information that they have asked for. That is another common complaint.

CHAIR—Thank you for that perspective. As I said—

Senator WATSON—The Taxation Institute raised the issue, as a central feature, about the difficulties of obtaining advice.

CHAIR—I am going to have to ask that any other questions are taken on notice for a supplementary submission. I make no apology for being firm on this. We have been flexible through the day, but we are now eating into the time of the last witness. The one thing that will not alter is the finishing time because people have flights to get, so we are going to finish at 4 pm. Very quickly, Senator Watson, would you like the witnesses to take anything on board for a supplementary submission?

Senator WATSON—Perhaps the issue that you have raised about the difficulty in obtaining advice. That is a major problem because it is a compliance cost issue, and it is a certainty issue. Also, there is a huge cost, because very few people understand the law now. Mr Mills, Dr Dirkis and others probably do.

CHAIR—I am sure we would be grateful if you would put that on the *Hansard* record. What are you ruling? Would you like to give us your home phone number, Mr Mills?

Senator MURRAY—I think that falls into the category of dangerous praise!

CHAIR—Exactly. Thank you very much and thank you for agreeing to appear concurrently. It has been most helpful. No doubt, on behalf of your associations, you will follow our hearings pretty closely, and if there is anything you would like to add please do so.

[3.19 pm]

GRECO, Mr Anthony, Chief Executive Officer, Taxpayers Australia

CHAIR—Welcome, Mr Greco. Thank you for being here. I want to give you the same time we have given all the other witnesses. We have until exactly 4 pm, at which point we need to adjourn. Do you have a brief opening statement that you like to make or would you like to go straight to questions? We have your submission and we have all read it. Is there anything you would particularly like to add?

Mr Greco—Obviously, I do not want to repeat what has been stated. A lot of the comments that have been made while I have been in this room I agree with—probably not the FBT issue with respect to taxing the employee rather than the employer, but I agree about the complexity of the FBT system and the compliance burden that is imposed on the taxpayer to deal with that system. I appreciate the opportunity of providing direct comments. I will try to be brief. Essentially, the first part of the submission was the self-assessment and the complex legislation.

CHAIR—We have read the submission. We have all got the submission in front of us, so do not feel the need to—

Mr Greco—I will say a few little points.

Mrs BRONWYN BISHOP—Make the points you were going to make.

Mr Greco—We understand that the ATO has effectively outsourced the checking process under self-assessment. It is a balancing act. For the self-assessment system to work properly we cannot have complex legislation. We have got the reverse. Going back to what Senator Andrew Murray mentioned, we have got an imperfect vehicle that we keep adding to. That causes problems. The self-assessment system will not work with complex legislation. We have over 70 per cent of the population having to go to a tax agent to complete a simple return. That says a lot about our system. That is all I want to say.

Senator MURRAY—Just to get it fixed in my mind and probably for the record, how many members does Taxpayers Australia have and what kinds of members are they? Are they individuals with businesses or what?

Mr Greco—That is a good question. We represent the smaller end of town. Our membership base is tax practitioners. Every tax practitioner has a reach of thousands. Direct memberships: we probably have about 10,000 members. Some of those are individuals but the bulk of them would be tax practitioners.

Senator MURRAY—By practitioners, do you mean agents, accountants?

Mr Greco—Absolutely. We have people in business who are looking after corporates. Then we have tax professionals who are obviously looking after their clientele. We represent quite a number of taxpayers in that process.

Senator MURRAY—Did you say 10,000 members?

Mr Greco—Correct.

Senator MURRAY—Would it be fair to say that they each reached 100 clients?

Mr Greco—I would say that the number would be greater than that. As to the composition of tax practitioners and people in business, I do not quite have those numbers but I would say conservatively yes.

Senator MURRAY—If it is 100, it is six noughts, so it means a million taxpayers, which is very substantial as a reach. How do you survey their views? How do you get input that you are accurate in terms of your opinions and what you put to us?

Mr Greco—As part of our services we provide a helpline, so we almost provide a similar service to the tax office whereby a tax practitioner will ring our office and try to get some certainty on a tax matter. We have a direct link with the tax profession in their frustration in trying to deal with the complexity of the tax system.

Senator MURRAY—Where is the greatest concern of, shall we call it, the average taxpayer? I do not know if such a being exists. If you were to identify an area that must be addressed by government, what would it be?

Mr Greco—The complex nature of the legislation, going back to your argument is, for example, definitions. You would have a definition of small business; you will have one for income tax—or various definitions for income tax—on what is a small business; then you go to GST and it will have its own definition of what is a small business; and then you go to fringe benefits. Throughout all the legislation and all the different taxing acts you do not have any consistency. That is one of the major problems.

Senator MURRAY—It seems to me that one of the ways in which other countries have dealt with this problem is to simply say to people, 'You don't have to be in the system.' They do that in one of two principal ways: either you apply thresholds at such a level that you do not have to do returns and you are not part of the tax system, so you raise the tax-free threshold effectively, or you say to people, 'You don't have to put in tax returns because you do not have to put in tax returns. All you do is pay the tax which is formally collected, such as through a PAYG system, but you do not get to claim tax deductible expenses or anything else. You simply accept the way it is.' Is it easier to go that route than to try and reform the complex system we have?

Mr Greco—Other countries have adopted that model whereby the lodging of a tax return is not necessary because the PAYG system they have in place looks after those obligations, so for the majority of taxpayers there is no requirement to interact with the tax system. I am not sure that that model would work within our tax system. Because of the nature of work deductions being claimed, the different circumstances of various taxpayers, it may not work in the Australian environment without undoing some of the complexity that currently lies in the tax system. We also have the interaction of the social security system with the tax system. That presents some major barriers towards that objective. Certainly, there is nothing wrong with moving in the direction of that model, but you could not do that with our current system.

Senator MURRAY—You are right about its complexity. I think the Treasurer said that with the latest low-income tax offset the tax-free threshold is effectively a little over $10,000, and yet I recall that at the $20,000 mark there is $1.2 billion of work related expense deductions. This churning that goes on seems absolutely crazy to me. If I interpret your remarks correctly, if you want to revisit the system you have to revisit it in a holistic way—is that right? You cannot fiddle with it as it is.

Mr Greco—That is right. That represents a fundamental change. You could not simply implant that within our current environment.

Senator MURRAY—The Treasurer has shown an ability to take that sort of leap. The great virtue of the superannuation debate going on at present, regardless of whether you are a supporter, a sceptic or an antagonist, is that he has said, 'This is what we're going to do, and this drastically simplifies super,' which it does. Is that the sort of great leap that is necessary with the PAYG, FBT or CGT systems, simply to say, 'We're wiping out the way it was and it is going to be a brand-new world with the following principles?'

Mr Greco—There is opportunity to look at the system holistically and to move towards something that you are contemplating—absolutely. You would have to have some provision to look after the social security aspects which are entangled within the tax system, so you would have some severing of those two. But you could move towards the standardisation of work deductions, depending on what sort of work a person does, and streamlining the pay-as-you-go tax to reflect that level of deductions and then conceptually do away with income tax returns.

Senator MURRAY—I have written elsewhere that trying to deal with the tax and welfare intersects has the effect of squeezing a balloon so that it is narrow at one point and pops out in a larger form elsewhere. It is very difficult to address.

Mrs BRONWYN BISHOP—Following up on that point, for people who have simple tax returns and simple, predictable deductions, why couldn't you put in one return and establish it as your base, and you only put in another one if you want to vary it?

Mr Greco—I suppose that is a model that could work. There is a lot of that already embodied in the tax system. If, for example, a logbook varies by more than 10 per cent then there is no need to revise your percentage of business versus private. Something of that nature could work.

Mrs BRONWYN BISHOP—It seems to me that, if you look at the structure of our system and the Australian psyche, people like tax deductions. People like to get something from the tax man because they think he is cheating them anyway. You can complain about it and say what you like, but that is the way they think about it.

CHAIR—They like a return.

Mrs BRONWYN BISHOP—The psyche is such that we like tax returns. It seems to me that there is no reason why you could not do it, particularly with self-assessment. I guarantee that, if you look at a lot of people's returns, they would be a duplication year after year.

Mr Greco—Studies have been done. As far as taking that away from the public is concerned, I think you will get a lot of objections, because it brings closure to the year. They find out how much tax they have actually paid and there is the opportunity to claim work deductions. Obviously, work deductions are rising faster than incomes, so the case is that either people are pushing the boundaries or they are becoming more knowledgeable—

Mrs BRONWYN BISHOP—More astute.

Mr Greco—More astute, using your words.

Mrs BRONWYN BISHOP—Another thing is that we know there is an overcollection of around $15 billion a year. We do not know what percentage of that is due to the uplift factor for the provisional tax that we have when we are not having provisional tax.

Mr Greco—Yes, I agree with that.

Mrs BRONWYN BISHOP—We need to extrapolate what that percentage is. But it seems to me that we could even look at the following concept. Indeed, people sometimes use the overpayment of their taxation contribution as a method of compulsory saving, and I see no reason why that should not be rewarded. I see no reason why the commissioner should not indeed pay some interest on the money that he holds.

Mr Greco—The system works against you. I agree with some of the comments already made about PAYG, especially in relation to small business, in the sense that they are almost forced to accept a simple method—

Mrs BRONWYN BISHOP—Yes, they are.

Mr Greco—because the consequences of going down the other routes have complexity involved and associated cost. So there is an overpayment of tax by small business purely because the system works against them.

Mrs BRONWYN BISHOP—Yes, it does.

Mr Greco—By the same token, because the measures go against the taxpayer and they are forced to adopt this position, maybe there should be some reflection or recognition that there is a cost to business and also to the individual.

Mrs BRONWYN BISHOP—That is right. Also, you have the situation whereby, if a small business person is two days late on their quarterly payment and the GIC applies, then that GIC stays in their account.

Mr Greco—Correct.

Mrs BRONWYN BISHOP—It does not matter if they pay another amount in—it does not come off, and it compounds. In my way of thinking, that is tax gouging.

Mr Greco—We have the same opinion: that it all works in one way, unfortunately.

Mrs BRONWYN BISHOP—Yes, it does. And all the risk has been shifted, unfairly in my view, from the commissioner onto the taxpayer. If the taxpayer who has to make those quarterly payments chooses to vary that tax payment, the risk they then incur is by far disproportionate to the money they might keep in their pocket, so they keep overpaying.

Mr Greco—That is right. The threshold currently stands at 15 per cent. It is actually quite difficult to work that out in a practical sense—to know whether you are within that limit or not. That is why I referred to the fact that most people just accept overpayment as a matter of commercial practice.

Mrs BRONWYN BISHOP—That is right.

Mr Greco—There is no reason why that should be the situation, given that the commissioner imposes GIC if you get it wrong.

Mrs BRONWYN BISHOP—Exactly right. The GIC rate was increased. I remember that it used to hover around eight per cent. It was whilst I was Minister for Aged Care that the dictum came around that the Treasurer had decided to raise the GIC level because, if it had stayed at eight per cent, people might have regarded it as a soft banking option. I hear that they are still talking about it in that way at 12.68 per cent—it is just a nonsense. It was hiked up for no reason other than to collect more money. In the way that the commissioner now keeps an integrated account for each taxpayer, so that all the heads of tax are collected together, it seems to me that it would not be difficult for him to pay interest to the taxpayer on the overpaid amount. That would equal out some of the unfairness.

Mr Greco—I think the inspector-general has that in his submission. We fully support it. The general interest charge and the other penalties are a double-edged sword in the sense that, yes, you have to discourage people from using the ATO as a source of funds but at the same time it does encourage taxpayers not to confess past sins. We mentioned the fringe benefits tax. There are probably only 50,000 employers who actually pay fringe benefits tax, but there are a lot of employers who operate outside of it purely because of the compliance costs and also the costs of penalties if they were to confess. So it is a double-edged sword at the end of the day.

Mrs BRONWYN BISHOP—Is FBT an efficient tax or should it go?

Mr Greco—I agree with most of the comments. When you look at the cost of compliance and the revenue generated, it is almost in the territory of the superannuation surcharge, where we had a system that applied that was totally impractical.

Mrs BRONWYN BISHOP—I think the surcharge went into the category of the streaker's defence: 'It seemed like a good idea at the time.'

Mr Greco—Whatever. But the fringe benefits tax has been with us since 1985. It is very inflexible; it is very rule driven. I agree with the remarks that Michael Dirkis made in the sense that it tries to catch everything and then there are a few exceptions. It has not modernised itself. It does represent the real cost of doing business. If Treasury could loosen the shackles just a little bit that would remove some of the compliance headaches. Most of the professional bodies,

including us, have reported to Treasury on the bugbears in relation to it. So they are well documented. It is not a case of not doing anything about it.

CHAIR—Can we get a copy of that?

Mr Greco—Absolutely. It would be with Treasury.

CHAIR—Would you be able to forward us copy?

Mr Greco—Yes, absolutely.

Mrs BRONWYN BISHOP—Fifty per cent of all fringe benefits tax collected relates to motor vehicles, as I understand it.

Mr Greco—It is probably a higher proportion than that. I cannot quote it exactly.

Mrs BRONWYN BISHOP—I think superannuation comes next.

Mr Greco—Exactly. Then you have benefits that are exempt that do not appear anywhere. They do not appear on the return, they do not appear as reportable and they do not appear on the payment summary group certificates. They are invisible and no-one has figures on them.

Mrs BRONWYN BISHOP—Then we get the magic grossed up value so that all those people who are paying child support are paying a notional figure.

Mr Greco—The complexity involved in putting an amount on the group certificate as part of the reportable figure has a lot of computations involved. They are quite complex.

Mrs BRONWYN BISHOP—There is no way an ordinary taxpayer could do it.

Mr Greco—It is a very difficult process that one has to go through to compute it properly. There would be a lot of genuine errors because of the complexities involved. It is beyond the scope of this meeting to cover those. I do agree that the cost of compliance compared to the revenue generated shows that there is a real opportunity to streamline it. The bank's reducing the regulatory burdens on business report on improving productivity has highlighted that and made a couple of recommendations. The government has been prompt in already earmarking some improvements. As the institute commented, it has released just a little bit of pressure, but the pressure is mounting.

Mrs BRONWYN BISHOP—The other thing is capital gains tax. Again, there is complexity. I have long been an advocate and remain an advocate for capital gains tax per se to be abolished. It should be replaced with a speculative gains tax whereby over a period—and you can choose the number of years, such as five, seven or whatever you like—if you buy and sell an asset in the same financial year then you pay the top marginal rate. Then that gradually reduces into five or seven years—you choose—and after that it is free of capital gains. It seems to me that that would free up a lot of assets which are currently held simply because people do not want to realise that asset and pay the capital gains tax. I think that would relate a lot to the secondary property market—that is, people who own a second property, who might make totally different decisions.

The people who make big decisions about renovating their homes might decide to spend that money in a different way if it were not the exempt entity. That is not a good reason for taxing the family home. To my way of thinking, capital gains tax does distort the tax situation. To me, that is a good reason to get rid of the tax and replace it with one that works.

Mr Greco—I agree it is a complex set of rules. There is precedent overseas for that method whereby, the longer you hold an asset, the less capital gains tax is applied. I probably do not want to comment any further than to say that we do have complex rules in relation to capital gains and that there is some merit for imposing a lower rate of tax on assets held for longer than 12 months. It does influence people's behaviour. I suppose the property market needs to be forewarned of any changes, because it will have quite large ramifications.

Mrs BRONWYN BISHOP—It will have ramifications, but they could be very positive ramifications.

Mr Greco—Absolutely.

Mrs BRONWYN BISHOP—The first principle in tax—and this has to be acknowledged—is that nothing drives behaviour like taxation policy. It dictates the way people make their investment decisions and the way they spend their money. It is the main driver of behaviour, and to pretend that it is not is to stick your head in the sand.

Mr Greco—Absolutely. We have a favourable tax environment for essentially non-productive assets in Australia. We continue with that policy because it adds rental capacity to the market. That is probably the objective that we are comfortable with. But, from a global perspective, should we be giving these tax concessions to an essentially non-productive asset?

Mrs BRONWYN BISHOP—That depends on which school of economics you belong to. The school that regards the family home as an expenditure would prefer you not to own a home but to rent and to use your capital to invest in something else. I do not belong to that school. The school that says that the family home is part of the savings mechanism is where I put myself. It depends on which side of the argument you fall down on as to how you treat the family home.

Senator MURRAY—You were referring to negative gearing, weren't you?

Mr Greco—Yes.

Senator MURRAY—You cannot reform capital gains unless you reform negative gearing.

Mr Greco—Yes.

Mrs BRONWYN BISHOP—The reform I just advocated would work perfectly well with negative gearing.

Senator MURRAY—You have to abolish negative gearing.

Mrs BRONWYN BISHOP—No, I do not agree at all.

Senator MURRAY—We will have that debate later.

Mrs BRONWYN BISHOP—The previous Labor government tried it and the investment market went belly up. It is a very effective way of getting the private sector to provide public housing.

CHAIR—It almost destroyed the rental market.

Mrs BRONWYN BISHOP—It did.

Senator MURRAY—I dispute that. I have read the arguments.

Mrs BRONWYN BISHOP—Of course, negative gearing applies to shares as well.

Senator MURRAY—Exactly. That is the point.

Mrs BRONWYN BISHOP—It is not just the property market. I want to go to the question of public and private rulings. Both John and I were involved in the initial stages of an inquiry back in the early nineties which recommended they do that. My minority report said—and Senator Murray has also been mentioning it today—that we should not have the commissioner making rulings at will. If he wishes to make a ruling, it should be a regulation for a public ruling and subject to tabling and disallowance in both houses. We should be making the law; it should not be the commissioner who does it in the guise of interpretation.

Mr Greco—What we have now is a separation of tax law design from administration. I agree with the comments made before that sometimes poorly designed laws require the commissioner to step in and interpret some ambiguous laws.

Mrs BRONWYN BISHOP—It should come back to us, and that can be done by subordinate legislation. Senator Murray very ably described the function of the Senate Standing Committee on Regulations and Ordinances, of which I was deputy chairman for 6½ years. It is a very rigorous process and it ensures that regulation meets the requirements of the law. If there is need to change the tax law then we should do it by legislation. Let me tell you, every time we bring in a new piece of legislation in the tax area for innovative thinking, the number of bills that we have to bring in subsequently to fix the legislation up, because it was wrong in the first place, are legion. It is a bad way to do business. If we could have a subordinate legislation process, we would get much better outcomes.

Senator WATSON—Bronwyn, that is your fault, that is my fault and that is the fault of all parliamentarians.

Mrs BRONWYN BISHOP—You fought with me over the regulation.

CHAIR—Not now. Don't let him divert you, Mrs Bishop.

Mrs BRONWYN BISHOP—I agree with you, John. If we saw legislation before it came in, maybe we would do better.

Senator WATSON—Absolutely.

Mrs BRONWYN BISHOP—With the system of public rulings, technically the commissioner can stand up at a lunch at Gulargambone, make a speech and say that that is a public ruling. In fact, he has put in some formal ways in which he can do it, but technically he can do that if he wants.

Mr Greco—Unfortunately, we need guidance in a lot of areas. It is in response to a lot of the professional bodies' requests that rulings are made, because the law is unclear. We cannot move away from that under the current system, especially when new laws are designed and they are deficient. The commissioner has to step in and—

Mrs BRONWYN BISHOP—We should tell the government we need a fresh law, and we could bring it in quick smart.

Mr Greco—Part of the process that seems to be improving is that Treasury is looking at consulting more with the ATO so that they can make sure that the ATO does apply parliament's intent and does not change the interpretation of something in a way that is contrary to policy.

Senator WATSON—Can you give some examples?

Mr Greco—There are recent examples where bad legislation has caused the ATO to put out some rulings. One example is travel to and from workplaces. We started off with very bad legislation and the commissioner had to interpret that and say, 'Let's keep the status quo.' That was in response to a certain case which went through the courts. Again, we started from a position of bad legislation.

Mrs BRONWYN BISHOP—Tell me why the legislation is bad.

Mr Greco—It would take some time, but essentially it does not cover all situations.

CHAIR—Would you be able to send us something on it?

Mr Greco—Yes, we could.

CHAIR—A supplementary submission would be good because we can see it is complex.

Mrs BRONWYN BISHOP—Absolutely, and I agree that so much of the law we put through is deficient. It is not sufficiently debated and there is not sufficient attention to detail and follow-through.

CHAIR—Some of these case studies will be important for our report.

Mr Greco—At the same time you could adopt the principle, base type of legislation, where the intent—

Senator WATSON—But we have found out that has caused a problem.

Mrs BRONWYN BISHOP—I think it is worse. The idea that we should rewrite the tax act is a nightmare, because then we would never know what it meant.

CHAIR—If you could, send us something, and we can move onto the next—

Mrs BRONWYN BISHOP—With the legislation you have at present, at least you have a whole body of case law that tells you what it means, even if the commissioner does not always accept it. When you bludgeon him enough he accepts it.

Mr Greco—Sometimes when the legislation is written—an example is the medical expense rebate legislation—it leaves some doubt. You try to consult with Treasury as to exactly what it means and they just say, 'We've written it and it's now the ATO's problem to administer.'

Mrs BRONWYN BISHOP—That is bad.

Mr Greco—I know it is bad, but that is what does happen.

Mrs BRONWYN BISHOP—Yes, and it has to stop happening. Treasury should write better instructions for the writers in the first place.

Mr Greco—I agree, but that is not what takes place.

Mrs BRONWYN BISHOP—That is a very serious deficiency that needs to be tackled. On the other hand, if we had a second tier of subordinate legislation, it would improve.

CHAIR—That is more to the point.

Mrs BRONWYN BISHOP—There is a lot of talk about simplifying the tax system. The Treasurer says he is going to get rid of 4,000 pages of inoperative legislation and everybody says, 'Isn't that wonderful?' But one of the submissions here very properly says that that is not going to help much because it is already irrelevant. Do you have some positive suggestions as to areas to simplify and ways in which you think simplifying the tax system can be done?

Mr Greco—Obviously, the process that is already underway is doing nothing from a complexity point of view and to describe it as simplification is an overstatement. One of the simple things that can be done within the current confines of not making huge rewrites is to simplify definitions across the board so that you do not have multiple definitions. That is one example of a major improvement whereby the definition of something as basic as a small business would carry through all the various tax acts—GST, FBT, income tax—across the board.

Senator WATSON—What about the same regime for penalties, because they are very different?

Mr Greco—Yes.

Senator WATSON—GST is atrocious.

Mrs BRONWYN BISHOP—This is a very significant point. With ROSA, GST was totally left out, so technically the commissioner has no power to remit the GIC on the GST.

Senator WATSON—The GST is terrible.

Mrs BRONWYN BISHOP—It is a terrible mess. It is running in parallel but it has different laws applying.

Mr Greco—The new kid on the block is GST, and it is a very simple tax in principle: we will add 10 per cent to the—

Mrs BRONWYN BISHOP—It could have been a very simple tax—

Mr Greco—It could have been simple.

Mrs BRONWYN BISHOP—if we had just followed New Zealand.

Mr Greco—Yes. We have 1,000 pages and that is not including the rulings and all the interpretations of the acts. Everything that is in writing in relation to GST is actually a binding ruling on the commissioner, so we have a body of law that is far from simple. Going back to compliance costs, we have this reporting system where every entity, including individuals, has to complete a quarterly reporting document.

Mrs BRONWYN BISHOP—It is called the BAS.

Mr Greco—You probably remember the bible that was issued as part of A New Tax System—that thick booklet. Now, you are probably all aware that thousands of changes have occurred since the introduction of that book. People are trying to comply with a quarterly requirement. The rules have changed 10 times over but we are still required to report statistical information based on who knows what. They have not reissued that book. There is a huge cost—

CHAIR—That was since 2000.

Mr Greco—Yes. So effectively we have had five years worth of that. And remember the history behind the BAS or the IAS form. It went through a couple of major revisions because there was a bit of a revolt.

Mrs BRONWYN BISHOP—A backlash.

Mr Greco—So we are all spending time and money providing statistical information which is of suspect value because no-one really knows what exactly needs to be reported. The liability or the amount being refunded is probably okay; it is just all the statistical information that is the problem.

Mrs BRONWYN BISHOP—Can I ask you this? On page 75 of our submissions we have a list of the most common mistakes made in the BAS and the GST.

Mr Greco—Sure.

Mrs BRONWYN BISHOP—It is pretty fundamental stuff—

Mr Greco—Absolutely.

Mrs BRONWYN BISHOP—but when I went around selling the GST—and I made a lot of speeches selling the GST—I used to say all you had to do, if it was a simple one, was put in one piece of paper: the amount of GST collected, the amount you can claim back and the amount you had to send in. 'Here's the cheque.' It was simple, easy—like New Zealand. Then suddenly when it came to the legislation they copped the BAS. God only knows where it came from. I really do not know. What purpose does that complicated BAS return serve? How does it better serve the government interests and therefore the interests of the taxpayer and what would happen if we implemented the system which we actually promised we would implement and said, 'This is the return you have to put in, not this very complicated BAS'? What would happen?

Mr Greco—The correct amount of tax is reported on that form, and there has been some improvement of putting all the taxes on the one form and remitting it at the one time. So there has been a movement forward.

Senator WATSON—But not if that brings forward tax payments for a lot of people.

Mr Greco—Correct.

Mrs BRONWYN BISHOP—Exactly; it is just giving more money for—

Mr Greco—Yes. However, there is the compliance aspect of completing that form, which has just increased substantially. And the cost is disproportionate because every business, including small businesses, needs to be a tax collector on behalf of the tax office, whereas under the previous model it essentially only affected people paying sales tax. We have consolidated all the obligations. Unfortunately, the compliance demands of GST are far from simple. There are too many exceptions. There are differences between GST and income tax and the rules are quite complex. I can give you plenty of examples where you have to do one thing for GST and you do something different for income tax.

Senator WATSON—Can you give us examples?

Mrs BRONWYN BISHOP—Could we have—

CHAIR—That was what I was about to say. We only have a couple of minutes left. You have made a good submission which has fleshed out a number of questions that Mrs Bishop has raised but, if you were able to provide us with another detailed supplementary submission that dealt with some of the examples we spoke of earlier and just now, that would be fantastic.

Mrs BRONWYN BISHOP—That would be fantastic.

CHAIR—I flag with Mrs Bishop and Senators Watson and Murray that, given the import of that—and it has come out in today's hearing—if you want to appear again to talk about that, we will be having hearings again in Canberra and in Melbourne. We are going to wrap up in a few

minutes, but the purpose of these hearings is such that, if there is a new area of ground that we would like to flesh out in a public hearing, we would be minded to do that.

Mrs BRONWYN BISHOP—Could you give me a bit of an answer to that question? What useful purpose is served by the BAS?

Mr Greco—The way I see it is that the ATO gather real-time information. It is the ATO, rather than waiting for an income tax return to be lodged, capturing sales and purchase information. What are the ATO doing? How can they substantiate the compliance costs of people having to report that? I am not sure. You would have to ask the ATO what they are actually doing.

Mrs BRONWYN BISHOP—If we ceased doing it and they only collected it once a year with the return, would we be worse off?

CHAIR—On GST?

Mrs BRONWYN BISHOP—No; you would still put in your monthly GST, but it is the rest of the information in the BAS.

Mr Greco—You would have to ask the ATO as to what use they put that real-time information towards, but there is a compliance cost.

Senator WATSON—What is the so-called statistical information you say they are collecting on GST returns?

Mr Greco—You have G1, sales, purchases, capital purchases—

Senator WATSON—Capital purchases help the taxpayer. Say you are a farmer and you buy a tractor or a big piece of machinery. That will tell the tax commissioner that there is a reason for your big refund this month. In a sense, that can save the taxpayer money because the commissioner has an immediate reference: 'He's bought some capital equipment and that's why he's up this month above the norm.' In a sense, that does help the taxpayer. What is your next one?

Mr Greco—GST-free exports, other GST-free supplies—

Senator WATSON—But most people do not have that.

Mr Greco—The biggest one would be G1—

CHAIR—You are going to provide us with some information on that. Like me, you are from the great city of Melbourne, I am told. We are going to have a Melbourne hearing and we will make sure that those dates work around you. This is an important area and probably needs another hour or so. If you are able to provide some of these examples and some of the backup, that would be good.

Senator WATSON—If you give the sales and it is a GST item, you can reconcile the GST amount that you have paid with your sales; otherwise you can go back and find you have

purchased something from a non-registered provider. That is quite all right, but at least you can identify it. It does protect you in any subsequent order.

Mr Greco—There are differences between a sale for income tax and a sale for GST, and they are the sorts of things—

CHAIR—And you will flesh those out.

Mr Greco—Yes.

CHAIR—We will have a date in Melbourne.

Mr Greco—There are all sorts of different treatments for GST as opposed to income tax, so you do have issues.

Mrs BRONWYN BISHOP—Before you close the hearing, can we authorise for publication the material about councils that we got from the Auditor-General?

CHAIR—There were some important questions relating to the Roads to Recovery program at an earlier public meeting we had on audit reports, and I requested, following some questioning by Mrs Bishop, that the Audit Office give us a detailed report on the example they had given in their report with respect to the Warringah municipal council. The Audit Office has written back to me and I requested that a copy be provided to Mrs Bishop, which has occurred. I move that those copies that have been received by me and Mrs Bishop be authorised for publication. There being no objection, it is so ordered. That will form part of the papers and that can be circulated to the other members on Monday.

Resolved (on motion by **Senator Watson**):

That this committee authorises publication, including publication on the parliamentary database, of the transcript of the evidence given before it at public hearing this day.

Committee adjourned at 4.00 pm