

**A Submission to the Joint Committee on Public  
Accounts and Audit Inquiry into "Certain Taxation  
Matters"**

By

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I thank you for the opportunity to make a submission to your committee. I am a former Australian Taxation Officer who has the academic qualifications of a Bachelor of Economics from ANU and a Master of Taxation from the University of New South Wales.

I am concerned that taxation law is being used by various interest groups to obtain financial advantage to the detriment of the taxation revenue and the bulk of individual taxpayers. These groups used the excuse of vague tax law to argue their special interest cases and to plunder the revenue.

The issues being examined by this committee would not arise if tax law was easily understood. Everyone should be able to expect consistent rulings, common standards of practice by the ATO, and the same level and similar application of penalties without entering a lottery of ATO office selection. Stories abound about certain offices being litigious whilst others are prepared to do deals.

Australian taxation legislation gives wide discretionary powers to Tax officers in an area which should be clearly defined. Taxpayers have the choice of seeking a private binding ruling or litigating their matter through the courts. Applicant taxpayers and their advisers say the option of seeking a private binding ruling arises because the Income Tax Assessment Act (ITAA) is too complex. If this is the case, it is the law rather than the process of interpreting it which needs to be changed. Law which is in disrepute or gives different decisions to different persons is in conflict with the intention of the founders of our constitution.

By recommending three courses of action this committee could simplify tax administration in this country.

**Tax Returns for Employees**

If PAYE taxpayers were not required to lodge tax returns a large workload would be removed from the Tax Office. In my estimation this would apply to roughly thirty percent of tax payers. This would have cost savings for both the Tax Office and individual taxpayers. Taxpayers could elect to have their tax taken out at the appropriate level and would lodge a statement with their employer that they agreed to that occurring. If taxpayers needed to be enticed into this system, the ATO could offer everyone taking up this option an automatic \$1000 deduction. The audit effort involved with PAYE taxpayers is expensive, and its cessation would result in a large efficiency gain for the nation.

Research reported in the Australian Financial Review "Call to drop tax returns for employees" by Alessandra Fabro on 15 April 2004 states that Professor Chris Evans from the Australian School of Taxation at the University of New South Wales has indicated that up to 4 million Australians might take advantage of this system. This system would be politically attractive to voters, and would bring Australia into line with the UK and New Zealand, which have already introduced a non-return system for salary and wage earners.

Taxpayers who wish to may remain in the tax return system, but they would face the prospect of higher audit action.

### Removal of Deadweight Costs from the Tax System

The second action, which would result in the removal of deadweight costs to the Australian community, would be to reduce the top tax bracket to the same level as company tax. The current system encourages high income earners to incorporate and shift their affairs into companies and trusts solely to bring their effective tax rate down towards thirty cents in the dollar. By reducing the highest level to that of companies, not only would the deadweight costs of running and maintaining these artificial entities be cut, but the available market for overseas tax arrangements and artificial schemes onshore which waste much of the ATO's time and deplete the revenue would be squeezed.

### What Have Public Companies to Hide?

Thirdly, the secrecy provisions of the taxation legislation should be amended to make company tax returns public. Public companies receive certain tax benefits because they have a widespread ownership. This occurs mainly under the capital gains section of the legislation. All public companies should be observing the same tax laws, and the laws should be applied uniformly. Companies' tax returns should be put on the public record alongside their annual accounts. Disclosure requirements of corporate law administrators require that companies disclose information which is significant for shareholders and creditors to base their decisions on. The company tax return would be one of the most significant documents in this regard. The information in private binding rulings is information that should be available to all the owners of the company, as well as any audit activity to which the company is subject.

### 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.**

### Private Binding Ruling System or Written Interpretative Decisions

The current private binding ruling system {written interpretative decisions} of the Australia Taxation Office (ATO) is a threat to good governance in the collection of taxation revenue because it allows different interpretations of the same legislation to be issued, resulting in an inequity in the application of tax law.

### Governance

Rulings are sought to obtain clearance of an individual taxpayer's action in interpreting the law in a particular way. In no other jurisdiction is such option available. The real situation of the taxpayer can be hidden from public scrutiny because of the secrecy provisions of the ITAA. The taxpayer can also, in reality, obscure their real situation from the ATO because if the ATO is short of resources and has limited knowledge of the industry in which the taxpayer operates, all the relevant information is not on the table for proper decision making. The result is usually expensive to revenue and disadvantageous to other taxpayers in the same industry, as the applicant taxpayer gains huge tax advantage.

The current system provides a starting point for the dishonest and unscrupulous to find an uneven playing field where they can enjoy tax benefits unavailable to other taxpayers. Further the taxpayer is able to influence any further proper review of the situation by claiming that the ATO is prejudiced against them.

### History

The author was employed by the ATO during the period 1989 to 1996. My duties included advising on private binding rulings. In seeking precedents within Tax Office records to provide a ruling, I came across a ruling which was found to be wrong in law. The ruling in question had stated the taxpayer's requirement in the first paragraph but had failed to identify the correct section of the Income Assessment Act which was applicable. The one hundred and forty paragraph ruling was an excellent dissertation on a complex and difficult part of the Income Tax Assessment Act, but did not address the issues which needed to be addressed so as to correctly examine the issues in question and come to a legal solution. A public ruling along with a change to the Income Tax Assessment Act were required to resolve the matter.

### Results of the Ruling

The ruling gave the particular taxpayer an advantage of \$28 million at then current prices. As numerous other firms in the same industry had obtained similar private

binding rulings, the industry-wide loss to revenue was calculated at approximately \$1.5 billion a year.

### Action by the ATO

The response by a senior ATO officer, when lobbied by the tax professionals acting for the industry concerned, was to suggest that all corrective action on the ATO's part cease. The reason for this decision was that the estimation of the loss to revenue was wrong. In the senior officer's estimation, only \$500 million each tax year had been lost. The officer argued that because the estimate on which action against the taxpayers had commenced was wrong, all action to rectify the situation was to cease.

### Remedy

All complaints against the private binding ruling system would be rectified by ceasing the practice altogether and requiring taxpayers to use the appropriate legal remedies already available under the ITAA.

If the second best option is to be accepted, that is, keeping the private binding ruling system, there needs to be transparency, honesty and unbiased application of the law. There must be independent auditing of decisions to ensure that the leakages to revenue outlined above do not occur. Such a system needs to be implemented to ensure that the law is applied equally to all taxpayers. The current actions of the ATO to provide a uniform ruling system are found at <http://law.ato.gov.au/atolaw/print.htm?DocID=PSR%2FPS200111%2FNAT%2FATO%2F00001>.

This system is not transparent. Whilst appearing to have checks and balances in place because the panel includes external representation, review is still hidden behind the secrecy provisions of the Tax Act. Parliament needs to take control of the system and review all private binding rulings and where the law is unclear, initiate action to clarify it. The task is very large at present due to parliament letting this area slip to the ATO/ tax experts' domain.

For people trying to gain an advantage under the private binding system, any action of the ATO is interpreted as an implied bias against them and in favour of the revenue. For some tax professionals, failure to obtain a favourable ruling is a loss of income for their client and a potential loss of clients for them. The fact that the reason for having an income tax system is to raise revenue seems to have eluded many taxpayers and their advisers.

The private binding ruling system represents a huge potential leakage to the revenue and a threat to voluntary compliance. It also provides potential for corruption.

I have two comments to make on the last three aspects of Part A of the Committee's review.

## eTax

The eTax system is unambiguous in its format in the main module. It is clear in its instructions and easy to follow. Returns with a number of sources of income can easily be completed. The capital gains tax module, unfortunately, requires effort to understand and knowledge of the law to come to the right answer. The capital gains module has some software problems and can cause a computer to hang on occasions.

## Penalty Actions

By passing all penalty actions to the courts, accusations that the ATO is failing to administer the penalty regime would be removed.

## 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.**

### Intersection of Fringe Benefits Tax and Family Tax Benefits.

If the committee were to recommend the reduction of the top marginal rate to the company tax rate, much the double taxation consequences arising from the intersection of fringe benefits and family tax benefits would disappear. Further welfare should be in a separate Act so that the costs of welfare can easily be identified and targeted to the appropriate beneficiaries.

Wealthy Australians benefit from nearly \$8 billion in annual tax breaks that the poor are unable to draw on, according to an Australian Council of Social Service study. (“Rich tax breaks ‘strip poor of \$8bn’ by Christine Wallace 13 April 2004 The Australian newspaper, and “Call to scrap tax breaks for rich” by Matt Wade April 13, 2004 Sydney Morning Herald). High income earners are able to access these benefits by the use of family trusts, company cars, income splitting, salary sacrificing for superannuation, income diversion into private companies to lower tax rates, and executive perks such as salary sacrifice for shares and termination payments bearing a lower tax rate.

Tightening tax breaks for the rich could fund serious improvements in the family tax benefit for low and middle-income earners, and help the 860,000 children living in jobless families. If a taxpayer is a party to fringe benefit tax, then in all honesty they should not be receiving family tax benefits.