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Dear Sir/Madam

The NTAA's primary area of expertise is in federal taxes, especially income tax and the GST. Since we provide a voice for tax agents and others in the tax profession, we are involved in matters that directly affect our members, including measures which affect their workload and stress levels, as well as administrative issues. We also tend to educate our members about the *current* tax law (or proposed changes) rather than lobby the Government on issues of policy, unless our members specifically request us to do this, or the tax law is patently unfair or unclear in relation to a specific issue – we recognise that the actual nuts and bolts of the tax law will depend on the tax policy of the Government of the day.

Therefore, this submission is concerned primarily with Q8.2 in the Consultation Paper, though we will also make a number of general points about reforming the Tax/Transfer System.

Q8.2 How might the process of personal income tax returns be simplified, including by removing the requirement for some taxpayers to lodge returns?

At the outset, it should be said that we are not against simplifying the tax system, or returns themselves, so that people feel more comfortable about completing and lodging themselves, should they feel confident enough to do so. However, we would not support any moves to take away from taxpayers the obligation to lodge a tax return each year.

First, this is almost certain to result in a reduction in the refunds that taxpayers will receive, as they fail to claim deductions for expenses they incur in deriving their income. Even if a corresponding entitlement was offered to taxpayers (such as an automatic deduction, as flagged at page 177 of the Consultation Paper, or a tax offset) in return for not lodging a return and claiming their deductions, we are certain that, despite the best intentions of today's policy makers, such an entitlement would be only temporary and could be taken away at a future point in time, by a Government hoping to further simplify the system or raise revenue. At the very least, we expect the entitlement would fail to keep pace with inflation. There is precedent for this happening on a grand scale in the 1970s, when the deductions for a dependent spouse and children (and variable deductions for expenditure on essential items which increase in cost with number of dependents, such as medical and educational expenses, house and water rates, life insurance and so on) were replaced with tax offsets which were then either removed or remained stagnant.

Secondly, the Tax Office should not be given the power to determine people's taxable incomes without their direct input – this is a slippery slope that could lead to honest citizens suffering a reduction in take-home pay (whether or not the ability to claim deductions for work related expenses are taken away).

In addition, from a public policy perspective, enforced lodgment of annual returns ensures that people do not "slip through the cracks". That is, at a time when the Tax Office and the Government are expending huge energies to crack down on tax avoidance and the black (or cash) economy, allowing people to opt out of their civic obligations can only ensure further avoidance. In addition, without regular returns being lodged, the ATO's ability to fight avoidance will be crippled, as the information and statistics they rely on from the information disclosed in returns will be compromised.

Last, and in a related point, Michael Carmody, the former Commissioner of Taxation, referred to the tax return as a "social document" – it went far beyond simply enabling a correct determination of income tax payable. It is used for the purposes of ascertaining entitlements to a large number of social benefits (such as the family tax benefit, the many tax offsets, and the various child care benefits), or liability to other payments, such as the Medicare levy surcharge and HECS, as well as for general information gathering, which assists with formulating future policy and targeting future action or attention. In addition, the current Government has recently expanded the role of the various income tests – including (or expanding the use of) such items as reportable superannuation contributions, investment losses and reportable fringe benefits. The best way to ensure that these income tests operate as intended is to have complete tax return coverage.

Submissions from our members have also highlighted the fact that tax returns are now used for verification purposes by many businesses and government authorities. For example (taken from a submission made to us):

- To obtain loans (car, house, personal loans, etc). Since "anyone can print off a PAYG Summary with the modern Accounting Software", now Finance providers are asking for both the assessment **and** the Income Tax Return for proof of income. In addition, "Often a person still in the same job will be paid by two or three different departments and are issued with 2 or 3 PAYG Summaries in a year. Even some Government departments have done this".
- To rent a house/home if no previous local history.
- The Immigration Department requires them if a person is applying for permanent residency, etc.
- Insurance – to obtain Life, Income Protection, Public Liability etc.
- Centrelink (and Child Support) – they apparently require the Income Tax Returns and Assessments for all types of benefits. "I know that Centrelink can obtain the information but the Interviewers require assessments and tax returns as it costs Centrelink time and money to request the details so they take the easy option and ask the person receiving the benefit or applying for a benefit to provide copies of them." Also, "There are many taxpayers in the building trade that have many different types of income and how will they prove their income if returns are no longer required?"

The New Zealand comparison

We also wish to address a comment that Dr Henry made in his speech on 12 November 2008 regarding Australians' usage of tax agents and a comparison with New Zealand: "In the 2005–06 income year, around 11½ million Australians lodged tax returns. Of these, 73 per cent - some 8½ million returns - were submitted by tax agents. This reliance on professional help is much greater than in other countries: in New Zealand, only 30 per cent of returns are submitted by tax agents. The cost of managing the tax affairs of Australians is significant, and it's growing. We should be reducing that cost as a matter of urgency."

Whilst these figures do appear incongruous at first, we would point out that the tax system itself in New Zealand is much simpler, and much narrower, than in Australia, which leads to a simpler tax return for taxpayers to complete. For example, New Zealand does not have a capital gains tax (CGT) system, and we would submit that CGT is one of the main reasons for Australian taxpayers to seek out a tax agent. As a further example, the New Zealand tax return refers to 3 "rebates" (though there is a separate "rebate claim form"). The Australian tax return has 14 tax offsets, and these are constantly changing with Government policy. The New Zealand return also does not deal with the Medicare levy surcharge, anti-avoidance measures (such as label A3 in the Australian tax return), more complex international taxation rules...and so forth. If returns are going to be abolished, then the Government must also consider the abolition of the Medicare levy surcharge, some or all of the international taxation rules, and possibly even its ability to pursue taxpayers for avoiding their taxation obligations, amongst other things.

A note about complexity

We want to point out that everyone assumes that complexity is automatically bad, but we submit that complexity in tax law – in particular, in income tax law – is necessary in order to ensure fairness, particularly in the modern world.

Tax authorities from other countries constantly look to Australia and the Australian Taxation Office to see how best to reduce tax evasion. Minimising tax evasion ensures that everyone pays their "fair share", which allows the Government to then reduce the overall tax burden. As people are able to take advantage of loopholes in the law, or other tax avoidance or evasion strategies, then the Government needs to proportionately increase the tax burden on the remaining members of society who are paying their taxes – normally salary and wage earners, who have very few means available to them to avoid tax.

The price for this is a complex tax system.

One example of complexity raised in the Consultation Paper is self-education expenses (on page 171). This complexity does not arise as a result of any specific legislative provision in the tax law, but due to the underlying basis of income taxation in Australia, which ensures that taxpayers only pay tax on their 'net income', after allowing for outgoings incurred in producing that income. By necessity, due to many different circumstances that taxpayers find themselves, all of which would be impossible for legislators to foresee, this often means that the courts must provide interpretation/judicial resolution for specific cases. This is how our legal system works generally – not just for tax law – and we think that, in general, it is a good system.

We submit that the goal of this aspect of the tax law (i.e., ensuring that taxpayers only pay tax on their net income) outweighs the resultant increase in complexity. Allowing the courts to decide on individual circumstances ensures fairness, and, over time, certainty. We submit that alternatives such as, in this case, either not allowing deductions for self-education expenses or, even worse, getting rid of the notion of taxing net income altogether, would not be in the interests of Australian taxpayers or the tax system generally.

Another example of a complex part of law that allows greater collection of revenue combined with greater fairness is the application of the low income tax offset. Particularly in recent years, the low income tax offset has been used to ensure that low income earners effectively receive a higher tax-free threshold than other taxpayers. Taxpayers who earn less than \$30,000 p.a. are entitled to the full low income tax offset of \$1,200, effectively giving them a tax-free threshold of \$14,000. The offset then phases out for incomes over this limit, eventually phasing out completely at \$60,000 p.a. Obviously, at this point, the tax-free threshold will simply revert to the standard \$6,000 (unless they have been a non-resident for any period longer than a calendar month during the year). This is recognised as being equitable

and fair and also protects the revenue – it ensures that low income earners can pay less tax, but does not apply across the board to all taxpayers. That said, it adds complication to the tax law, and is not easy to administer (or even explain), although taxpayers are largely kept out of the whole equation, as the Tax Office automatically calculates the amount of the offset on the basis of other information lodged in the tax return. Therefore, although there is some cost here, we would submit that the cost is outweighed by the benefits.

Another example raised on page 172 of the Consultation Paper is deductions for superannuation contributions. The main reason behind allowing these and other superannuation concessions is to encourage Australians to make provision for their retirement, which has many benefits for those individuals (and the country) beyond increasing their own living standards above that provided by the age pension. All Governments have used the tax system as a means of encouraging or discouraging certain behaviour – the Government's recent Small Business and General Business Tax Break being one of the more obvious and current examples – and there is no reason to suppose that this will not continue in future. So it must be acknowledged that any attempt to reduce complexity in the tax system in the immediate future is likely to be overcome by subsequent policy changes.

For this reason, we submit that, irrespective of complexity, it is better to simply achieve the best possible tax system now – being consistent, fair and broad in coverage, recognising that future Governments will obviously make changes to that system.

Finally, in the arguments about compliance costs, it should not be forgotten that costs associated with complying with the tax laws are specifically deductible under S.25-5 of the ITAA 1997, reducing the financial effects of these costs.

Reforms we support – Income tax

First, we submit that the re-write of the taxation laws should be finalised, once and for all. It is ridiculous that we still have two, separate and, in some cases, overlapping, Income Tax Assessment Acts.

We agree that a consistent definition of income (and other terms) is a desirable aim (which is already being tackled by the current Government), as having different definitions of income seems to introduce complexity for no good reason. There have been many other examples of different definitions within tax legislation, such what constitutes a "small business", or who is a "dependant" for tax and superannuation purposes.

Also on page 172 of the Consultation Paper, in relation to complexity for business, we agree that the taxation of trusts needs to be clarified, if not simplified, and we do not support the current position of the Tax Office regarding the operation of S.97 of the ITAA 1936, and the definition of "income of a trust estate" it has argued in the case of *Bamford* (at the time of making this submission, the Federal Court's decision in this case is still pending).

The recently proposed changes to the small business CGT concessions mean that they should operate as intended, but it should be recognised that the simplifications and concessions for smaller businesses are often anything but.

Our members, and the association itself, primarily deal with small and medium sized businesses, so we have little exposure to such issues as consolidation, the taxation of financial arrangements and foreign issues, such as the FIF and CFC rules. That said, these laws may be necessarily complex, due to the potential for such taxpayers (including both residents and non-residents) to circumvent Australia's tax laws.

Reforms we support – Other taxes and transfer payments

As stated above, much of the federal income tax law is complicated, but it is carefully weighed to provide the greatest benefits at the lowest costs and, in particular, restrict the ability of citizens to dodge their obligations to pay tax. This allows the overall tax burden to be lowered and spread more evenly across Australian (and foreign) taxpayers. The same could be said for the GST (subject to the concessions that were made on its introduction).

However, this is not the case with respect to many taxes levied at State level, and we fully support critically reviewing them and considering their eradication. This includes payroll tax – a tax on employment – and stamp duty – a tax to place a stamp on a document, but which invariably far outweighs the cost of doing so and, in addition, massively distorts the market as people try to avoid the exorbitant costs involved in the select number of transactions that stamp duty targets. Some of these have already been removed in conjunction with (in theory) the introduction of the GST, but more could be done, especially in relation to the taxes that the State Governments committed to removing but which, some at least, have failed to do in accordance with their agreement. The fact that there are at least 125 taxes in Australia, 115 of which collect less than 10% of revenue, is outrageous.

Another issue where we agree reform would be welcome is in the area of welfare – referred to “transfer” payments in the Consultation Paper. For one thing, the income tax system should get back to being about collecting revenue for the Government to implement its policies – too often the Government of the day attempts to provide middle-class welfare via the tax system – perhaps so it can be seen to be “reducing taxes”, rather than “providing welfare”. But to be truly efficient, these two arms of Government should be separated. The tax system should be “clean” – it should simply be about collecting revenue as fairly and efficiently as possible from all members of society. Where the Government feels it should then provide relief to certain sectors of society, it can then do so through either directly or indirectly as welfare. To mix the two is to muddy the waters, and makes the administration of both that much more difficult.

We also agree that the many welfare payments made by the Government should be reviewed to make them fairer and more efficient. In particular, the high effective marginal tax rates imposed on people on welfare as they return to work and/or receive higher incomes must be examined, as they represent a clear disincentive to work.

Finally, since this Government has expressed a commitment to reducing the country's carbon emissions, a review of environmentally friendly (and unfriendly) taxes should also be considered, including the effects of the fuel tax credit system, and even the introduction of a carbon tax as opposed to a cap and trade system (particularly if this can be offset by the elimination of other taxes, e.g., introduce a carbon tax on environmentally damaging businesses in return for the removal of payroll tax).

Yours faithfully



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