

Chapter 1

# Australia

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<sup>1</sup> The views expressed in this chapter are those of the authors and do not necessarily reflect the views of Atax, University of New South Wales, or the Fraser Institute. Information provided by Nick Botfield, Director of Pre-filing of Tax Returns, Australian Taxation Office (ATO), is gratefully acknowledged, as are the comments of an anonymous referee of this chapter.

# 1 Introduction

Like the rest of the developed world, Australasian tax reforms in the past 30 years have exhibited many efficiency-enhancing features: lower income tax rates, tax base broadening, a change in tax mix towards indirect taxation, and increased neutrality and uniformity in tax structures. In New Zealand and Australia, these outcomes have reflected the pro-market policies initiated in the 1980s by the then Treasurers Roger Douglas and Paul Keating, respectively. Increased legal complexity and increased tax operating costs (defined as the sum of tax administrative and compliance costs) were undoubtedly outcomes that derived from such policies in Australia and New Zealand, as well as in Canada and most certainly the United States (see Sandford, 1993). This is ironic as tax simplicity has long been recognized as a criterion for good tax policy and tax simplification was declared to be a key rationale for many of the tax reforms taking place in the 1980s and 1990s. The increase in tax operating costs (whether in absolute or relative terms) and the loss of tax simplicity have also clashed with the stated economic strategy of microeconomic reforms in many member countries of the Organisation for Economic Co-operation and Development (OECD).

Prefilled (or pre-populated or pre-completed) income tax returns represent one of the latest tax simplification initiatives being undertaken in many OECD countries (Highfield, 2006; OECD, 2008). Their use began in Denmark in the late 1980s and subsequently has spread to other Nordic and EU countries (ANAO, 2008). They have also been adopted, or are in the process of being adopted, at sub-national levels in North America (for example, in California and Québec). In Australia, the prefilled tax returns program (formally known in Australia as “pre-filling service - e-tax” or simply “pre-filling,” a terminology adopted in this chapter;<sup>2</sup> is relatively new, having been first mooted in 1998 and formally introduced in 2006/07 after minor trials in earlier years.

More recently, pre-filling has received high-level official endorsement, initially from the *Henry Review of Australia's Future Tax System* (Australian Treasury, 2009), and subsequently in the Government's response to that review (Australian Government, 2010) and in the May 2010 Budget. Recommendation 123 of the *Henry Review* argues that “pre-filled personal tax returns should be provided to most personal taxpayers as a default method of settling their tax affairs each year” (2009: 104). In turn, the Government has apparently accepted this “tick and flick” approach, though—as discussed later in the chapter—it may not have entirely understood the ramifications when it did so.

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2 While “pre-filling” appears as “pre-filling service - e-tax” on a web page of the Australian Taxation Office (ATO) (<http://www.ato.gov.au/individuals/content.asp?doc=/content/58871.htm>), it is known within the ATO as “pre-filling of income tax returns” or more often as just “pre-filling.” The term “e-tax” is omitted because e-tax is used by self preparers (individuals) while three quarters of pre-filling use is by tax agents via the Tax Agent Portal.

The principal aim of this chapter is to examine in detail the experience of pre-filing in Australia. The organization of the remainder of the chapter is as follows. Section 2 provides a more detailed background discussion of pre-filing in Australia, including the drivers of change and its historical development. Section 3 presents a description of the current state of play of pre-filing in Australia and discusses some of the issues that have arisen during its implementation. Finally, section 4 presents a preliminary assessment of the impact of pre-filing and considers a number of proposals that could enhance its performance.

## 2 The development of pre-filing in Australia

### 2.1 The drivers of change

As in the case of many other OECD member countries, the introduction of pre-filing in Australia can be seen as a direct result of two separate developments: [1] the desire for income tax simplification; and [2] improvements in information and communication technology.

Personal income tax (PIT) in Australia is imposed by the federal government and collected by the Australian Taxation Office (ATO) in accordance with the Income Tax Assessment Act 1936 (Cth), Income Tax Assessment Act 1997 (Cth) and other legislation, including the Tax Administration Act 1953 (Cth). It is by far the largest single source of tax revenue in Australia.<sup>3</sup> The simplification of PIT has been a major and ongoing issue in Australia. This is because the Australian PIT has long been perceived as being complex by all conventional measures such as legal complexity, tax compliance costs, and proportion of personal taxpayers using professional tax advisers.

In terms of sheer size, Australian income tax legislation is massive.<sup>4</sup> The length of the Income Tax Assessment Act 1936 (Cth) has increased from 126 pages at its inception to over 5,000 pages prior to the introduction of the Income Tax Assessment Act 1997 (Cth). The combined length of the two Acts now stands at about 7,000 pages, after the recent removal of a significant number of pages (close to 30%) of inoperative provisions in the 1936 and 1997 Acts. Reading the Australian income tax legislation is difficult and

3 In 2007/08, PIT raised net revenue of AU\$128 billion, accounting for over 61% of income tax revenue, almost 45% of all federal tax revenue, and almost 37% of all tax revenue (ABS, 2008).

4 In Australia, the Tax Law Improvement Project (TLIP) was launched in 1994 with the simplification objective of rewriting the 1936 income tax law to provide a better structure and make it easier to understand. As a result, an updated but incomplete income tax act was passed in 1997. Due to the discontinuation of the TLIP in 1998, income tax in Australia is now governed by two parallel pieces of legislation: the Income Tax Assessment Act (ITAA) 1936 (Cth) and the Income Tax Assessment Act (ITAA) 1997 (Cth).

requires university education. Attempts at legal simplification by rewriting tax legislation in simpler English and a more coherent manner have yielded very limited successes.<sup>5</sup>

In a (now dated) comprehensive study of the compliance costs arising from federal taxes, Evans et al. (1997a: 20) found that in 1994/95 personal taxpayers (excluding sole traders) spent, on average, 8.5 hours per annum on tax affairs and almost AU\$100 on tax adviser costs (CPI indexed to AU\$137 in 2006/07 prices; ABS, 2009: tables 1, 2). In aggregate terms, the compliance costs accounted for 4% of the net income tax revenue collected from personal taxpayers.<sup>6</sup> Although there is no updated study of the compliance costs arising from personal income tax in Australia, it is reasonably safe to conclude that the overall level of tax compliance costs has not shown any sign of declining. Indeed, the average costs to an individual for managing tax affairs (essentially fees paid to advisers and excluding the value of the taxpayer's own time or any incidental costs) was AU\$268 in 2006/07, an increase of nearly 7% on the 2005/06 figure (ATO, 2009a: 140).<sup>7</sup>

In an earlier publication based on the same study, Evans et al. (1997b: 52) found that the most common reason (62.3%) for people to seek professional advice was to comply with the legal requirements imposed by their tax obligations. In this regard, the proportion of individual taxpayers<sup>8</sup> relying on the services of tax agents for the completion and lodging of their tax returns has increased tremendously, from approximately 38% to 40% in 1977/78 (McKinstry and Baldry, 1997) to well over 70% in the period since 1996/97 (Davidson, 2009: 6–7). Australian individual taxpayers are generally considered to be among the most agent-dependent in the developed world (McKinstry and Baldry, 1997: 126). An OECD survey established that 77% of all PIT returns in Australia were prepared with the assistance of tax professionals in 2004 (OECD, 2005: table 9). Only Italy (with 96%) had a higher figure than Australia. However, the proportion of individual taxpayers using tax agents has slightly decreased in recent years, falling from a peak of 77.53% in 1999/2000 to 72.46% in 2006/07 (ATO, 2009a: 9).<sup>9</sup>

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5 According to Smith and Richardson (1999: 330), the Flesch readability index has improved from 38.44 for the ITTA 1936 to 46.42 for the ITTA 1997. Both scores fall well short of an index of 65 for plain English speaking.

6 This does not include the tax compliance costs of the PAYE system, trusts, and so on. When sole traders were included, individual compliance costs accounted for 5.6% of the relevant tax revenue (Evans et al., 1997b: 65).

7 Note that the estimate by Evans et al. of tax adviser costs refers to personal (individual non-business) taxpayers only, while the ATO estimate is related to all individual taxpayers.

8 Including both personal (individual non-business) and individual business taxpayers.

9 Arguably, and intuitively, this reduction in dependency upon tax agents may be connected with the growth of e-filing generally and pre-filing in particular, although there is as yet no empirical evidence to prove that this is the case.

It is thus not surprising that Australian federal governments have taken an active role in attempting to simplify the PIT system in the past 20 years. Various reports have been commissioned and various initiatives undertaken: for example, the Beddall Report (Parliament House of Representatives, 1990), the 1990 Tax Simplification Task Force, the Joint Committee of Public Accounts (JCPA) Report (1993),<sup>10</sup> the “A New Tax System” initiative (ANTS) (Costello, 1998), the Review of Business Taxation (the Ralph Review) (1999), the Banks Report (Regulation Taskforce, 2006) and, most recently, the Henry Review (Australian Treasury, 2008). In addition, strong calls for tax reform have been received in the past ten years from different quarters of the Australian society (for a summary, see Tran-Nam et al., 2006). However, many of these proposals focus mainly on tax simplification from a policy perspective (such as the removal of work-related deductions or “negative gearing”<sup>11</sup>) rather than focusing on the simplification of tax administration.

In Australia, annual filing of income tax returns under the principle of self-assessment has been mandatory for most individual taxpayers for many years. As noted by the OECD (2008: 5), this is similar to the case in about 15 of the 30 OECD members, where the system of personal income tax effectively requires universal filing. Some have contended that Australia should adopt appropriate administrative reforms that would place it in the other half of OECD countries where universal filing is not required. For example, Evans (2004) has argued the case for reduced annual filing for certain personal income taxpayers in Australia. He identified three conditions for making such a reduction possible: [1] fewer personal tax rates (Australia has had up to five or six); [2] a more comprehensive and cumulative regime for withholding taxes at source; and [3] the removal of most work-related deductions. To date, however, Australia has not moved in this direction, preferring instead to adopt the less radical alternative of pre-filing returns, recognized by some as the next “big thing” in the administrative reform of the Australia’s PIT system (Highfield, 2006).

The need to simplify personal income tax highlighted above has been accompanied by significant improvements in information and communication technology and the ability of revenue authorities to harness these developments. These improvements have resulted in a substantial reduction in the costs of storing, transmitting, retrieving, and manipulating massive amounts of tax-related data. Further, the widespread availability of PCs and the Internet, as well as the improvements in database languages and integrated software, has made it feasible for the ATO to offer improved electronic services in

10 The Atax study undertaken by Evans et al. (1997a, 1997b) was commissioned as a direct result of the JCPA’s recommendations.

11 “Negative gearing” refers to the income tax law that allows individual taxpayers to deduct expenses incurred on investment activities (such as shares and real property) from their taxable income in a non-quarantined manner.

response to taxpayers' needs. In this sense, the use of prefilled tax forms is closely related to the ATO's use of data matching in tax administration.

## 2.2 Historical overview

The concept of pre-filling in the PIT system has been on the political and administrative agenda in Australia for over ten years, and has enjoyed political support from both the previous Liberal (Coalition) federal government (in power from 1996 to 2007) and its Labor successors. In its ANTS document (Costello, 1998: 148–49), the Liberal federal government foreshadowed the introduction of prefilled income tax returns by discussing the replacement of the taxpayer annual tax return by an income statement generated by the ATO for personal taxpayers with relatively simple tax affairs. It was stated that the ATO would introduce a test of these income statements for the financial year 2000/01 (Costello, 1998: 149), although nothing specific appears to have subsequently emerged from this announcement. In its 1998/99 report on tax file management, the ANAO (1999) suggested that the ATO should be able, in principle, to provide the information it had available in its data matching activities to certain types of taxpayers to simplify the completion and lodgement of their annual income tax returns. The ATO accepted this recommendation, although again little appears to have happened in the immediately following years.

In March 2002, the ATO commenced its “Listening to the Community” project aimed at making it easier, cheaper, and more personalized for taxpayers to comply with their tax obligations. The project consisted of focus groups, creative retreats, and surveys with various user groups (tax agents, small business, individuals, large business, and not-for-profit and government organizations). The program was first documented and published in 2003 (ATO, 2003) with annual updates. The second guiding principle of the program, which stated that “taxpayers will have on-line access to information that is personal to their dealings with the ATO,” was closely related to the ultimate introduction of pre-filling.

The ATO introduced the practice of pre-filling returns using e-tax (a free tax return preparation and lodging software for self-preparing personal taxpayers, first developed by the ATO in 1999) in the financial year 2004/05 (ANAO 2008: 84). In this pilot, the pre-filling information was limited to two types of data collected by agents of the Australian Federal government, namely, Centrelink (social security) payment summaries and medical expenses recorded by Medicare Australia. In 2005/06, the pre-filling pilot was expanded to include the 30% childcare rebate, and interest and managed fund information from selected financial institutions.

In the 2007/08 budget speech, the then federal Treasurer Peter Costello (2007) announced that an additional AU\$20 million would be provided to the ATO to enable it to design and implement a more comprehensive pre-filling service for personal income taxpayers in 2007–08 and subsequent financial

years. Costello stated that the intention of the initiative was to simplify the completion of tax returns for about nine million Australian taxpayers who lodge their tax returns either by e-tax (self-preparer) or via their tax agents. Pre-filing was expected to be fully operational in 2008/09.

The amount of information and the functions available from the ATO as part of the pre-filing have steadily increased over the years. For the 2006/07 financial year, pre-filing information was received from third parties progressively throughout July and August 2007. The pre-filing data available to e-tax users in that year was rather limited and included details related to various government payments, the 30% child-care tax rebate details, interest income, dividend income, and certain managed funds distributions.

In the 2007/08 financial year, the information and functions of pre-filing were expanded. The pre-filing options available in e-tax and the Tax Agent Portal became identical. In addition to the data available in 2006/07, e-tax users and tax agents could also access details of:

- Medicare levy related items, including private health insurance details;
- Higher Education Loan Program (HELP) and prior year deductions;
- Pay As You Go (PAYG) payment summaries submitted electronically (only available through e-tax in 2007);
- Baby bonus information (only available through e-tax in 2007); and
- Family Tax Benefit (FTB) status indicator (only available through the Tax Agent Portal in 2007).

E-tax users were also able to import their reports into their agents' software. Similarly, tax agents could make use of the multi-tax file number (TFN) function that allowed them to enter up to five client TFNs and Medicare card details at the same time.

In addition to the range of information available for pre-filing in 2008, the 2009 e-tax pre-filing service provided the following information:

- PAYG payment summaries that have been sent to the ATO on a paper form;
- PAYG income tax instalments;
- relevant items of private health insurance rebate details;
- rental property address details from taxpayers' 2007/08 rental property schedule; and

- reminders of letters that had been sent to taxpayers throughout the year in relation to their work-related expenses and notice if they needed to submit a schedule of work-related expenses this year.

The introduction of pre-filing in Australia has thus followed an incremental path—pre-filing data has been enhanced gradually over time.

### 3 Description of pre-filing in Australia

#### 3.1 How pre-filing currently works

The implementation of the pre-filing program has been coordinated by the Electronic Initiatives of the Micro Enterprises and Individuals Business line of the ATO. It is still in an early stage and the focus to date has been upon consolidating the existing data and addressing issues raised with the ATO by agents and through feedback and at consultative forums (D'Ascenzo, 2009).

Pre-filing in Australia basically leverages the ATO's data matching activities. In fact, pre-filing is defined by the ATO as the provision of information that it typically uses for data matching purposes, directly to an individual e-tax preparation or record-keeping tool. Thus, the option of using prefilled income tax returns is only currently available to individual taxpayers who have lodged at least one tax return through e-tax, and authorized tax agents through the Tax Agent Portal. Pre-filing in Australia is not yet available to those using paper-based income tax returns (who may be self-preparers or who may be using a tax agent with a paper-based workflow).<sup>12</sup>

Pre-filing is intended to make the completion of electronically submitted income tax returns easier, faster, and more personalized. For personal taxpayers, it may also reduce the likelihood of later tax review or audit since the pre-filing information provided to taxpayers is basically the same as the matching data used by ATO in auditing.<sup>13</sup> To take advantage of pre-filing, e-tax users are required to review the pre-filing information, amend it (if necessary), and add any missing data. At this stage, it is strongly recommended that e-tax users review pre-filing information as it may be erroneous or incomplete. Taxpayers remain responsible for the returns they lodge,

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12 According to published statistics, about 11.8 million individuals lodged income tax returns in 2006/07 (ATO 2009a: 10). About 25% or 3.3 million were self-preparers while the vast majority lodged through tax agents. Among self-preparers, approximately 1.4 million did not use e-tax and 1.9 million lodged through e-tax. Among e-tax lodgement, about 61% or 1.16 million made use of pre-filing.

13 This view is supported by Nick Botfield, ATO's Director of Pre-filing of Tax Returns, who also suggested that data on possible correlation between pre-filing and auditing will be collected by the ATO in the future (Botfield, January 2010, personal communication).

even if they have used pre-filled information. The use of e-tax (and thus pre-filling data) is not binding as self-preparing taxpayers can lodge their tax return on-line one year and by paper in another year. Also, those using e-tax do not have to use any pre-filled information that may be available—its use is entirely optional.

### 3.2 Information currently provided by pre-filing

Pre-filing is only relevant for personal taxpayers when they are in the process of preparing and lodging their compulsory annual tax returns. Individual taxpayers not using tax agents are required to lodge their tax returns of the last financial year (July 1 to June 30) by October 31 of the new financial year. For individuals using tax agents, the due date is extended to May 15 of the following year.

The information that is currently available to taxpayers under the pre-filing service is a mixture of rolled-over information from earlier years' returns and third-party information made progressively available in the period from July to October immediately following the close of the fiscal year (June 30); most of this is available by mid-August. The following information is provided (ATO, 2009b):

- personal details, including name, address, and Australian Business Number (ABN), rolled over from the 2008 tax return so long as that was submitted using e-tax and the same computer is being used to submit the 2009 return;
- PAYG payment summaries received from third-party employers and containing details of salary, wages, allowances, earnings, tips, directors' fees, employers' lump-sum payments, Australian government allowances and payments, total reportable fringe benefits amounts, and various categories of other income;<sup>14</sup>
- government payments provided by agencies such as Centrelink, Department of Veterans Affairs and Department of Education Employment and Workplace Relations (this information includes details of taxable payments including pensions and allowances and tax exempt amounts that may relate to tax offsets);

<sup>14</sup> One change introduced in 2009 is that individual non-business payment summaries lodged on paper, not electronically are displayed in this "PAYG payment summaries" section. Approximately 7.8 million payment summaries were lodged by employers by July 28, 2008 and, by August 14, 2008, the figure had increased to 10.8 million, which represented a 37% increase in the number of payment summaries lodged on-line in 2007/08 compared to the preceding year (Bland and Clarke, 2009). The figures for 2008/09 are not yet available.

- interest income from a large number of financial institutions and share registries, including lists of income-bearing accounts (savings and term deposit) in the taxpayer’s name or held jointly with a spouse (from 2008 onward);
- dividend income (sole and joint with spouse) from most listed public corporations—so long as the corporation holds the TFN of the taxpayer concerned (which is not mandatory);
- managed fund distributions (sole and joint with spouse) from a large number of managed funds—so long as the fund holds the TFN of the taxpayer concerned (which is not mandatory);<sup>15</sup>
- a very limited set of deductions (relating to work-related uniform or clothing, other work-related expenses and gifts or donations) and only available where the total deductions claimed on the 2008 tax return amounted to less than AU\$300;<sup>16</sup>
- HELP and Student Financial Supplement Scheme (SFSS) data;
- data on the status of Baby Bonus claims for those who have previously claimed this allowance and who have an on-going entitlement to claim;
- Medicare benefit tax-statement details for the taxpayers and their dependents under 18, showing amounts paid for medical expenses and claimed back from Medicare;<sup>17</sup> and
- details of private health insurance policy and rebates, which can obviate the need for the individual to complete these details on the tax return.

In addition, in 2009, new details or reminders were displayed under the “Important information” section (where relevant to taxpayers) about rental

15 Bland and Clarke (2009) note that the number of “investor records” (presumably a combined total of the three categories of interest income, dividend income and managed fund distributions) increased by 65% in 2007–08 compared to 2006–07, to a total of 49.3 million records lodged on-line by the end of October 2008.

16 Given that 80% of individuals (7.6 million) claimed work-related expenses in 2006/07 at an average of over AU\$1,800 per claimant (ATO, 2009a), it is likely that there would be very few taxpayers who are able to take advantage of this aspect of pre-filing.

17 This information is used to establish whether the taxpayer may be entitled to a 20% tax offset for medical expenses and may calculate it in limited circumstances—though the likelihood of the existence of medical expenses not dealt with through the Medicare system and the exclusion of spouses mean that the data will be complete for only a few individuals.

property addresses from the 2007/08 rental property schedules, pre-lodgement advisory letters, schedules of work-related expenses required with lodgement, income from forestry managed-investment schemes, the entrepreneurs' tax offset, the remaining balance of any land-care and water facility tax offsets, PAYG income tax, the accumulative low rate cap, income averaging for primary producers and special professionals, and net farm management account deposits or withdrawals. Information about the status of Family Tax Benefit (FTB) claims has been removed from the 2009 pre-filled form as a result of the 2008/09 Federal Budget decision to transfer the administration of FTB payments to the Family Assistance Office.<sup>18</sup>

### 3.3 Participation in pre-filing

The use of the pre-filing service has been monitored by the ATO. The use of pre-filing, both by e-tax self-preparers and tax agents, has increased substantially in the past two years (tables 1.1 and 1.2). This rapid rise in the popularity of pre-filled income tax forms, particularly in 2007/08, is possibly due to:

- the 2007/08 Budget announcement of the pre-filing initiative;
- pre-filing becoming more visible in e-tax; and
- more pre-filing information becoming available, making it a more useful service to a wider group of taxpayers.

But, note that no information is available on the extent to which individuals retrieving pre-filled data used the various categories of information. For example, an individual may have used data from only one or two categories in 2006/07 and data from three or four categories in 2007/08; but it is also possible that an individual may have used fewer categories in 2007/08 than in 2006–07. The totals are merely raw totals of individuals who used some aspect of the pre-filled data in each of the years and do not show the extent of use.

<sup>18</sup> The Family Tax Benefit assists families with the cost of raising children. It is payable to children under 21 years or full-time students aged between 21 and 24 subject to various conditions including an income test. Prior to July 1, 2009, the ATO acted as an agent for the Family Assistance Office (FAO) and administered claims for FTB. In a streamlining administrative reform announced in the 2008/09 federal budget, the option of receiving payments and service delivery from the ATO was removed from July 1, 2009 onward. FTB will now be administered by FAO via Centrelink or Medicare Australia. In short, FTB is now viewed by the government as a social welfare (family) issue rather than a tax issue.

**Table 1.1: Participation in pre-filing by self-preparers, 2006/07–2008/09**

	2006/07	2007/08	2008/09 (at Dec. 9, 2009)
Total e-tax lodgement	1,917,171	2,216,706	2,356,410
Number of e-tax lodgers who used pre-filing	1,162,339	1,548,253	2,110,292
Ratio of e-tax lodgers who used pre-filing (%)	60.6	69.8	89.6

Source: Bland and Clarke, 2009; unpublished data provided by Nick Botfield, Director of Pre-filing of Tax Returns, Australian Taxation Office, January 2010, personal communication.

**Table 1.2: Downloads of pre-filing reports via the Tax Agent Portal, 2006/07–2008/09**

2006/07	2007/08	2008/09
<i>July 1, 2007–Dec. 9, 2007:</i> <b>1,604,649</b>	<i>July 1, 2008–Dec. 9, 2008:</i> <b>3,586,841</b>	<i>July 1, 2009–Dec. 9, 2009:</i> <b>4,895,845</b>
<i>July 1, 2007–June 6, 2008:</i> <b>1,930,252</b>	<i>July 1, 2008–June 6, 2009:</i> <b>6,164,159</b>	<i>July 1, 2009–June 6, 2010:</i> <b>7,500,000*</b>

\* Estimated.

Source: Unpublished data provided by Nick Botfield, Director of Pre-filing of Tax Returns, Australian Taxation Office, January 2010, personal communication.

## 4 An evaluation of pre-filing in Australia

### 4.1 General comments

Despite its conception dating back to the late 1990s, the implementation of the pre-filing initiative in Australia is relatively recent and is arguably only partial in comparison to programs in other countries. There is not yet sufficient quantitative data to analyze its impact on tax administration in any rigorous fashion. Nonetheless, it is possible to make a preliminary, qualitative examination of the impact of pre-filing based on [1] how it operates and [2] past empirical studies of tax administrative and compliance costs in Australia. It is helpful to start by making some overall remarks regarding this initiative.

The introduction of pre-filing of income tax returns is perceived as reform of tax administration. The pre-filing initiative is indeed primarily concerned with the administration of the tax system and it appears to be independent of the income tax law. Yet, it is not always easy to separate tax administration from tax policy. This is especially true in Australia, as pre-filing does not appear to have been an ATO-driven reform, at least initially. As discussed in section 3, the early impetus was provided by the Australian Treasury (in the 1998 ANTS document) and by the ANAO (in its 1998/99 report on tax file management), and the ATO largely reacted to those initiatives. Simplifying income tax returns was seen by the Australian Treasury, in the 1998 ANTS document, as a minor reform associated with the far more significant reform based on the Goods and Services Tax. In addition, the budget for developing pre-filing was provided by the Australian Treasury

to the ATO as an additional, separate resource, rather than from the ATO's existing, internal resources. Having said that, it seems fair to remark that, well before additional resources were made available to the ATO for the development of pre-filing, the ATO had taken a proactive role in making pre-filing inevitable through its "Listening to the Community" project discussed previously.

Pre-filing also has interesting, practical implications for two fundamental concepts in the administration of income taxation in Australia, namely self-assessment and tax auditing. The principle of self-assessment still requires taxpayers to keep records and justify their claims, and taxpayers and their agents can choose whether or not to avail themselves of any of the information that is made available. However, as more and more pre-filing data become available to e-tax users, and as they come to trust and use that information more and more, there may be a danger that the role of the personal taxpayer as a self-assessor becomes less well defined.

Similarly, the ATO's need to administer the income tax system via its tax auditing activities may change as pre-filing information expands. This is primarily because, in the past, the ATO possessed the same information as the pre-filing data but did not reveal that information to taxpayers. Rather, the information was employed in data-matching exercises as part of the tax auditing process of individual taxpayers. The availability of pre-filing data to taxpayers and their acceptance of the data may therefore diminish the need of the ATO to audit individual taxpayers. However, at the same time, the ATO can now focus its attention and efforts on those individual taxpayers who do not use pre-filing. This is consistent with the ATO's tax compliance model according to which those taxpayers who want to comply will be assisted to do so by the ATO.

## 4.2 Early problems

A number of teething problems with pre-filing have been identified by the ANAO (2008), the ATO (2009b), and the press (Sampson 2007; 2008): timeliness, comprehensiveness, availability, and reliability and accuracy.

### *Timeliness*

The first major issue is the timeliness of pre-filing information. The current legislation that regulates the provision of third-party information requires the employment and financial data be provided to the ATO no later than August 14 and October 31 following the end of the tax year, respectively (ANAO, 2008: 85). These deadlines are potentially too late for many e-tax users who want to submit their income tax returns early in order to get tax refunds, and have prompted the ANAO to recommend that the ATO "discuss with the Treasury ... bringing the dates forward for the provision of requisite third party data" (ANAO, 2008: 86).

### *Comprehensiveness*

As a direct result of the timeliness issue, the range of pre-filling information is, for practical purposes, currently not as comprehensive as the government would like it to be. The ANAO report notes, in particular, that the TFN is not always attached to third-party information, largely for privacy reasons, and recommends that the ATO should engage in initial discussions with Treasury in order to explore options for legislative change that would permit the inclusion of TFNs “on some additional data sets, having regard to the need to balance privacy concerns and improving the efficiency and effectiveness of public administration” (ANAO, 2008: 85–86).<sup>19</sup>

In addition, because of technical problems, some supposedly available pre-filling information may not actually be made available. For example, the ATO’s website in 2008 stated that the service regarding private health insurance information was turned off at a critical time because of technical problems associated with this information (Sampson, 2008).

### *Availability*

There may also be problems for personal taxpayers in being able to use the pre-filling service, as its availability is limited to the period when e-tax is available. For example, e-tax was only available for about six months following the end of the 2009 tax year, which meant that personal taxpayers who may have wanted to use pre-filling in that year could not always do so. Apparently the short time frame in that particular year was attributable to a major systems conversion that took place in January 2010 and was not typical: in other years it was available for between eight months and 11 months. It is understood that the standard ATO offering in future years is likely to be 11 months, which should obviate much of this problem.

### *Reliability*

A further issue is that pre-filling information may not be reliable. Some instances of inaccurate pre-filling data have been reported in the press (e.g., Sampson, 2007, 2008), although in response the ATO has claimed that the number of situations detected where pre-filling data has been found to be erroneous, measured against the number of downloads made in practice,

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<sup>19</sup> In Australia, there is privacy legislation designed to protect individuals from being identified in public documents or data sets. As a result of this privacy legislation, third-party data providers (such as banks) are not legally required to supply TFNs along with tax-related information although many of them choose to do so. When data are supplied without TFNs, the ATO needs to use its data matching search engine to identify the corresponding TFNs. The ANAO was seeking to make it legally mandatory for third-party data providers to supply TFNs.

has been miniscule. Nonetheless, in a self-assessing environment, a careful checking of pre-filing data is essential for all taxpayers and tax agents who choose to use it.

#### *Other problems*

Further problems with pre-filing have been identified by the ATO (2009b). These include human error in the external information-provider lodgement process and lack of understanding by taxpayers. Issues highlighted by the ATO itself are:

- duplicated records: affected investments show amounts that are double what they should have been;
- interest derived from share investments: prefilled interest from accounts unknown to taxpayers (because [1] interest-bearing securities reported by share registries rather than a bank, and [2] bank accounts overlooked by investors);
- reporting of interest, dividends, and managed fund distributions: occasionally reporting of investment income is undertaken by another organization related to the investment body, causing major confusion (e.g. Colonial First National reports on behalf of the Commonwealth Bank of Australia for some of their managed fund distributions); and
- taxpayers quoting incorrect TFNs to financial institutions.

### **4.3 Evaluation of benefits**

It has been claimed that pre-filing income tax returns generates substantial benefits to taxpayers, tax administrators, and governments (Highfield, 2006: 331; OECD, 2008: 4). Such claims are, however, often based on common sense rather than rigorous empirical study. This is surprising in view of the fact that pre-filing started more than two decades ago. In Australia, there is as yet insufficient quantitative data to make a carefully reasoned, empirical analysis. The qualitative assessment in this subsection will therefore focus on the likely impact of pre-filing on tax operating costs, initially from the perspective of administrative costs and, subsequently, in relation to compliance costs.

#### *Administrative costs*

In Australia, pre-filing could reduce tax administrative costs to the ATO via reduced needs for data matching, auditing, and tax-dispute resolution. At the same time, the uploading of pre-filing data to e-tax and the Tax Agent

Portal requires additional resources. Thus, the net saving in tax administration costs might not be as large as suggested in the literature. A more careful study to determine the reduction in tax administrative costs (if any) as a result of pre-filing is necessary.

#### *Compliance costs*

It is possible, conceptually, to identify a number of different ways in which pre-filing may reduce tax compliance costs. In the first place, taxpayer compliance costs may be reduced as a result of more individual taxpayers choosing to self-prepare and lodge their annual returns (with a commensurate reduction in the number using tax agents) as a direct result of the easier availability of data relevant to the completion of the return. Arguably, the benefit of the reduced fees that would need to be paid to agents would outweigh any increase in the value of time taken by self-preparers in submitting their returns. There may be some evidence that dependence upon tax agents is declining. The pilot pre-filing program was introduced in 2004/05 and expanded in 2007/08. From 2004/05 to 2006/07, there has been a steady decrease in the proportion of Australian individual taxpayers who use tax agents (Davidson, 2009: 6–7). However, since this declining trend had started as far back as 1999/2000, it is premature to conclude that pre-filing has resulted in a lower proportion of personal taxpayers who require tax agents to assist with tax affairs. Moreover, there is no evidence for, or against, the notion that taxpayer compliance costs have actually been reduced as a result of decreased dependence upon tax agents.

A second area in which there may potentially be compliance costs savings is in the reduced time taken by both self-preparers and tax agents in completing tax returns as a result of the more ready availability of data relevant to the return. Tables 1.1 and 1.2 in section 3.3 above suggest that the proportions of e-tax user and tax agents (who use pre-filing information) have been rising quite rapidly. In 2006/07, lodgements by e-tax grew by 20.6% to 1.9 million compared to the previous fiscal year, and overtook paper and telephone lodgements (1.4 million) (ATO, 2009a: 9). Pre-filing is likely to be taken up by younger personal taxpayers (who are more comfortable with e-tax) and personal taxpayers with simple tax affairs.<sup>20</sup> However, it may be over-optimistic to expect that this trend will continue unless pre-filing data continues to improve in terms of timeliness, comprehensiveness, availability, and accuracy.

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20 This is confirmed in the *Taxation Statistics* for 2006/07 where the ATO notes that “the proportion of taxpayers lodging returns [electronically] generally decreased with age,” although it is also noted that “by far the highest rates of growth [in electronic lodgements] were seen in those aged between 60 and 74” (ATO, 2009a: 9).

*Time savings*

Note that, under self-assessment, personal taxpayers who use pre-filling are still required to keep records as before and check their income tax returns carefully. Thus, time savings would not reduce record-keeping time<sup>21</sup> but would be limited to the completion and lodgement of income tax returns, and would therefore be relatively small in magnitude. In terms of time spent on completing and submitting income tax returns, there is a large difference between those personal taxpayers who self-prepare (2.2 hours annually) and those who use tax agents (1.8 hours annually) (Evans et al., 1997a: 77). Thus, pre-filling would be much more beneficial to self-preparers who lodge income tax returns on-line than those who lodge via their tax agents.

However the psychological benefits (knowing that one's own tax records are consistent with pre-filling data) may be substantial. It is also interesting to note that personal taxpayers' attitudes toward pre-filling may vary between different groups of taxpayers. Some taxpayers, mostly those with complicated personal tax affairs, may feel that the ATO knows little about them. Other taxpayers may be surprised to find that the ATO knows so much about their financial affairs.

*Three further points <recheck this section>*

First, the provision of third party information for prefilling requires resources by information providers and these costs have to be taken into account in assessing the benefits of prefilling

Second, the above discussion focuses on what are generally termed computational costs of tax compliance. Compliance costs also typically include planning costs as well as computational costs. There are no obvious theoretical reasons that pre-filling will reduce, or otherwise have any impact upon, the planning costs of tax compliance. Indeed, it is more than likely that pre-filling will have a neutral impact on tax planning costs.

Third, the opportunity exists for the ATO to gauge personal taxpayers' attitudes or perceptions toward pre-filling by including some appropriate questions in its annual taxpayer satisfaction survey.<sup>22</sup> Apparently some information about pre-filling will be published in future issues of the ATO's *Taxation Statistics*. It is therefore likely that the ATO will include specific questions about pre-filling in their future surveys, such as the Community Perception Survey.

21 Research indicates that actual record keeping is a relatively significant element of overall compliance costs for individual taxpayers—typically between 60% to 70% of the time spent by individuals on tax activities (Evans et al., 1997a: table 8.39).

22 At present, self-preparers can, in principle, provide feedback about their experience in using pre-filling in the annual survey of e-tax users but the results of these surveys relating to pre-filling are not yet publicly available.

#### 4.4 Means to improve

As discussed above, pre-filing requires timely, comprehensive, and accurate data from employers and financial institutions, preferably on-line. Given the current legislation governing the provision of pre-filing data to the ATO, the long-term viability and success of pre-filing will depend crucially on the voluntary efforts of providers of legislated data to submit data to the ATO on or before their deadlines. In the 2007/08 federal budget, the (then) Coalition government announced the New Business Intensive Assistance Program, which aims, among other things, to assist small businesses in Australia to report electronically (Costello, 2007). The program provides AU\$40 million over four years to fund individually-focused advice and assistance to new business. This includes assistance in registering with the ATO's business portal and completing the Business Activity Statement.

In addition, the ATO is actively engaging with the business sector in its pre-filing client contact program (Bland and Clarke, 2009). The principal aim of this program is to work with employers and investment bodies to encourage:

- early lodgement of payment summary annual reports (by July 28) and annual investment income reports (by August 8);
- on-line lodgement, using Electronic Commerce Interface (ECI); and
- on-line lodgement of TFN declarations and quarterly TFN reports.

A comparison of data received by the ATO via ECI as at October 31, 2007 and at October 31, 2008 seems to indicate that the ATO's pre-filing client contact program has been quite successful in achieving its aims (Bland and Clarke, 2009).

Another way to improve the program is to expand pre-filing beyond e-tax. At present, pre-filing is only available to personal taxpayers lodging on-line or personal taxpayers using tax agents. Making pre-filing available in paper form would be beneficial to those elderly personal taxpayers whose tax affairs are simple but who are not confident enough to lodge their income tax returns on-line. The availability of pre-filing data in paper form may reduce the need for those taxpayers to engage tax agents. This could then also have an impact on reducing the aggregate tax compliance costs. It would also have the effect of expanding (indefinitely) the current window of availability of the pre-filing service.

#### 4.5 Conclusions

The pre-filing initiative is partial and still at a very early and experimental stage in Australia. Moreover it is reactive (in the sense that the taxpayer or tax agent has to consciously engage with it) rather than proactive (as in the

Nordic countries where taxpayers receive the completed returns for checking or acceptance). Hence it would be premature and inappropriate to compare pre-filing in Australian with that in the Nordic region countries, where the initiative has been running on a broader scale for a much longer period.

Notwithstanding these differences, any initiative designed to enable taxpayers to reduce compliance costs and to comply with their tax obligations more easily has to be welcome. But it is unlikely, in its current form, either to have a significant impact on the compliance or administrative costs burden or to represent a significant step in the direction of a return-free tax jurisdiction for many or even some personal taxpayers. Its proponents must ensure that its continuing roll-out and development is carefully managed so that commentators do not attach to it unrealistic expectations of its capacity to reduce compliance or administrative costs or simplify the tax system that cannot be met in practice. Above all, there is a need for evidence on its impact to be systematically gathered, analyzed, and published.

Finally, such tax administrative initiatives critically depend, for their ultimate success, on the full support of political masters. As noted at the outset of this chapter, the Australian experiment with pre-filing appears to have such high-level support. In the Budget of May 2010 the Treasurer, Wayne Swan, fully endorsed the “flick and tick” (pre-filing) approach to personal tax returns argued for so strongly in the Henry Review delivered to the Government at the end of the previous year (Australian Government, 2010). However, contemporaneous actions of the Government, in ruling out others of the Henry Review’s recommendations that help to buttress this pre-filing approach, may to some extent dilute the ATO’s capacity to extend the pre-filing experiment as far in the direction of its Nordic and other counterparts as might otherwise have been expected (Evans and Tran-Nam, 2010).

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