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Australian Taxation Office

Submission responding to matters raised and questions taken on notice at the JCPAA public hearing on 22 June 2006

25 October 2006

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BACKGROUND

This submission has been prepared in response to the first public hearing of the Joint Committee of Public Accounts and Audit inquiry into a range of taxation matters which was held on 22 June 2006. It answers specific questions taken on notice and also provides further information on areas of interest to the Committee. This additional information may assist the Committee in its inquiries.

MANAGING DEBT SUBMISSION

The Tax Office has already provided answers to questions taken on notice in relation to the level of general interest charge, penalties, bankruptcies and outstanding BAS debt in a submission provided to the Committee dated 18 September 2006. This submission was titled 'Managing Debt'.

OTHER TAX OFFICE SUBMISSIONS

The Tax Office has previously provided three submissions in relation to the Committee's inquiry. These are available from the Committee's website on www.aph.gov.au. The submissions are:

- "Securing Australia's revenue, securing community conference" dated 5 April 2006
- "Moving on – aggressive tax planning" dated 7 June 2006, and
- "Managing debt" dated 18 September 2006.

INDEX OF QUESTIONS TAKEN ON NOTICE

This index summarises the questions taken on notice by the Tax Office at the hearing conducted on 22 June 2006. The index cross-references the relevant Hansard record with the page number for where the questions are addressed in this submission.

No.	Topic	Hansard ref.	Submission ref.	
			Chapter	Page
1	Provide a copy of the Tax Office Prosecution Policy	PA 7	Provided to Committee with covering letter	
2	Number of test cases funded in the last three years, as well as outcomes	PA 8	1: Test case litigation program	11-12
			Attachment 2	78
3	What is the process for awarding test case funding?	PA 8	1: Test case litigation program	10
4	Provide a list of unsuccessful applications and the reasons for being declined	PA 9	Attachment 3	89
5	What is the amount of money overpaid by taxpayers each year that is then refunded to them and calculated as a percentage of income tax revenue?	PA 10-11	4: Income tax refunds	18
6	How many taxpayers choose to obtain family tax benefit and private health insurance rebates through the tax system?	PA 11	11: Family tax benefits	55-57
7	Estimates of expected returns per extra resources going to the Tax Office in various segments	PA 16	6: Active compliance	29
8	Provide aggregate number of private binding rulings for different taxes	PA 18	7: Rulings	35
9	Provide number of public rulings by tax type	PA 19	Attachment 7	132
10	Provide an update on EBA situation	PA 21	14: Employee benefit arrangements	68
11	Revenue obtained from micro-business for latest available year	PA 23	8: Micro business	37
12	Provide draft public ruling on private ruling regime	PA 27	Provided to Committee with covering letter	
13	Provide number of investors taking advantage of managed investment schemes and number of product rulings issued in relation to each scheme product	PA 29-30	10: Managed investment schemes	52-54

No.	Topic	Hansard ref.	Submission ref.	
			Chapter	Page
14	Proportion of claimants of family tax benefit who claim as a lump sum at the end of the year, or as an ongoing PAYG deduction	PA 31	11: Family tax benefits	55-56
15	Level of funding provided to the Tax Help program and a background of the program	PA 32	12: Tax help	61
16	Can parents anticipating the 30% childcare rebate apply for a variation of their PAYG tax instead of waiting for a lump sum?	PA32	4: Income tax refunds	21
17	How many officers are involved in making public rulings?	PA 36	7: Rulings	34
18	What is the date of issue of the public ruling in relation to FBT and childcare and when it started applying?	PA 41	13: FBT and childcare	63
19	How much is collected annually from penalties and application of GIC?	PA 45	Managing Debt submission	
20	How many bankruptcies have been the result of the Tax Office bringing action?	PA 45	Managing Debt submission	
21	General information on the status of employee benefit arrangements and resolution with taxpayers	PA 47	14: Employee benefit arrangements	68
22	Running balance accounts – can a taxpayer specify to which account a payment is to apply?	PA 51	15: Running balance accounts	71-72
23	Provide the level of outstanding debt that relates to business activity statements	PA 51	Managing Debt submission	
24	How long does the Tax Office expect public rulings that relate to inoperative provisions to be revised?	PA 55	7: Rulings	35
25	In relation to “Then and Now” document, provide an explanation of why refunds as a percentage of revenue have increased	Via email	16: Total refunds	73-74

CHAPTER 1: TEST CASE LITIGATION PROGRAM

PUBLIC DOCUMENT RELEVANT TO THIS CHAPTER

The following document is available on the Tax Office website www.ato.gov.au and is relevant to the Tax Office's management of test case litigation:

- Test Case Litigation Program booklet.

INTRODUCTION

The purpose of the Test Case Litigation Program is to clarify the operation of the laws administered by the Commissioner of Taxation where:

- there is uncertainty or contention about the operation of areas of law
- the issue is of significance to a substantial segment of the public or has significant commercial implications for an industry segment, and
- it is in the public interest for the issue to be litigated.

In applying these criteria:

- cases with issues involving questions of fact where there are established legal principles will not generally be funded
- the program will usually be directed to applications for cases being litigated through Part IVC of the *Taxation Administration Act 1953*. Part IVC allows for the review of a Commissioner's decision on an objection to an assessment or a private ruling, an appeal to the Administrative Appeals Tribunal (AAT) or a court from the Commissioner's decision on an objection, or a subsequent appeal from an AAT or court decision. Preference for the program is given to court cases rather than AAT cases. Cases outside of the Part IVC regime involving debt issues, applications for declaratory relief, and judicial review issues, will be considered for funding where an important law clarification issue arises
- consideration will be given to the degree to which the taxpayer is prepared to cooperate to achieve an early hearing
- the financial capacity of the taxpayer to pursue litigation will be taken into consideration, although applicants of financial substance will not necessarily be excluded, and
- cases involving tax avoidance schemes or attempts to gain a benefit clearly not intended by the law will not generally be funded. Cases will be considered for funding where they test the proper meaning of anti-avoidance provisions or where the circumstances are such that there is a strong public interest served.

IDENTIFICATION OF CASES

Generally, cases will arise through applications for funding made by taxpayers. These are sometimes made before litigation has commenced but more commonly arise when taxpayers commence litigation against the Commissioner or during the appeal process. These

applications go to the Tax Office's Test Case Litigation Panel which makes recommendations about whether funding should be provided.

Submissions may also be made by, for example, a professional or industry body to have a matter of significance tested. In these cases, in principle agreement is typically sought to the matter being tested and a case being identified for this purpose. These applications are also considered by the Tax Office's Test Case Litigation Panel.

Similarly, the Commissioner may decide to test a matter and seek agreement from a taxpayer to proceed with the case. This may involve seeking the assistance of a professional or industry body to identify a suitable case. There are also cases where the Commissioner has offered to meet the taxpayer's costs in important cases, without an application for funding being provided. Although they are an important part of the Commissioner's Test Case Litigation Program, these cases do not need to go to the Tax Office's Test Case Litigation Panel, but details are provided for the Panel's information.

The Test Case function has been placed in the Strategic Litigation area of the Tax Office Legal Services Branch. This places the function in the area of the office that is well placed to identify issues of contention in the tax system, not only from current litigation, but also from participation in the Priority Technical Issue process of the office. The Chair of the Panel and the senior officer that manages the program are both members of the Priority Technical Issues Committee, which is chaired at the Second Commissioner level.

OTHER CASES FUNDED UNDER THE TEST CASE PROGRAM

For many years, when the Commissioner has appealed against a decision of the AAT or the Small Taxation Claims Tribunal, the Commissioner has generally considered funding the taxpayer's reasonable costs of the appeal. Funding of this kind will be provided, depending on the merits of the case and having regard to the size of the issue and the capacity of the taxpayer to meet legal costs. This funding has historically been done without reference to the Test Case Litigation Panel, however in more recent times the taxpayers affected have been encouraged to lodge test case applications. As they relate to an appeal on question of law, the funding is regarded as part of the Test Case Program.

When the Commissioner seeks special leave to appeal to the High Court, and the particular issues in a case justify it, the Commissioner may, of his own volition, offer to meet the taxpayer's costs of special leave and the costs of the appeal in the event that leave is granted by the High Court. This is done without reference to the Test Case Litigation Panel. As these are High Court cases, they are also regarded as being within the Test Case program.

TEST CASE LITIGATION PANEL

While the Commissioner is the ultimate decision maker on test case applications, there is an advisory panel that includes members external to the Tax Office. The current panel includes two senior tax officers, a former NSW Court of Appeal judge, a tax barrister, a tax lawyer, and a tax accountant. The names of the current and past external panel members are included at

Attachment 1. The external panel members bring a range of skills and backgrounds to assist in deliberations.

The panel considers the applications according to the program's criteria, and recommends to the Chair of the panel whether or not funding is appropriate.

The panel considers applications with respect to both actual cases and issues where no case has yet been identified.

The panel was formed with the intention of providing community input. Representatives from the accounting and legal professions provide independent views of the merits of cases and of the significance of issues to the community.

The submission and any supporting materials will normally be considered by the Test Case Litigation Panel (the panel) when it next convenes. The panel generally convenes four times a year, but that is increasing as applications have increased. There will be five meetings in the 2006 calendar year. As a consequence a decision can generally be made within three months of an application being received.

DECISION MAKING PROCESS

Applicants apply for funding by completing the application form and attaching with it a submission.

The taxpayer is requested to provide the details of the case, the factual background and a full summary of the issues to be tested. We request that the submission show how the issue in question relates to an area of the tax law that needs clarification and how it affects a significant number of other taxpayers. The significance of the case should be clear from the submission, including the amount of revenue that will be affected by the case, if that is known.

Comments are sought from internal Tax Office sources, which may include the relevant business line, the Legal Services Branch and the Tax Counsel Network. Any written comments received will form part of the papers forwarded to the panel. The relevant Tax Counsel officer would normally be invited to attend the Panel discussions to assist the panel with particular issues.

The panel consider whether or not the written application and the supporting documentation meet the specific criteria. A recommendation to approve or decline funding is then made to the Chair of the panel, who makes the final decision. It would be an extremely rare and exceptional instance for the Chair not to follow the advice of the panel.

Decisions about test case funding can also be made by a number of senior staff in the Tax Office, including the Commissioner, a Second Commissioner, or a Deputy Chief Tax Counsel (DCTC). A DCTC is the Chair of the panel, and is ordinarily the officer making the final decision about funding.

Depending on the strength of the application, a decision can be made without reference to the panel. This will happen where the application is approved due to the important issues that are raised, or where there is some greater urgency.

The applicant will be advised in writing of any decision, with reasons. If the application is declined, funding will not be given. A decision to approve funding does not give rise to an automatic legal right to funding – an agreement about the terms of funding has to then be reached. A draft Test Case Funding Agreement setting out the terms and conditions upon which funding is offered will be sent to the applicant for their consideration before they decide whether or not to accept the offer of funding.

CASES CONSIDERED UNDER TEST CASE FUNDING PROGRAM (03/04 – 05/06)

2003/04

Total cases considered by Tax Office:	30
Cases declined:	16
Cases funded after consideration by the Panel:	5
Cases funded other than through the Panel process	9
(3 Adverse Decision Policy Funding ¹ ; 4 funded at the Commissioner's prerogative ² ; 2 High Court ³)*	

2004/05

Total cases considered by Tax Office:	37
Cases declined:	17
Cases funded after consideration by the Panel:	10
Cases funded at the Commissioner's prerogative ² :	10

2005/06

Total cases considered by Tax Office:	35
Cases declined:	15
Cases funded after consideration by the Panel:	19
Other:	1 deferred

¹ Adverse Decision Policy Funding refers to cases where the Commissioner has received an adverse Tribunal decision and decides to appeal to the Federal Court.

² Funding at the Commissioner's prerogative refers to cases where the Commissioner has unilaterally offered to meet the taxpayer's costs, in important law clarification cases, without an application for funding being provided.

³ The High Court will often expect that the Commissioner will meet the taxpayer's costs of an appeal before agreeing to grant leave on the Commissioner's application. Costs are usually provided based on the orders of the court rather than by a separate deed entered into with the taxpayer

Total over last 3 years:

Total cases considered by Tax Office:	102
Cases declined:	48
Cases funded after consideration by the Panel:	34 ⁴
Cases funded other than through the Panel process:	19
	(plus 1 case deferred)

SUMMARY OF APPLICATIONS DECLINED (TOTAL 48)⁵:

Unlikely to provide law clarification	34
Low relative importance of the issue combined with the financial capacity of taxpayer	3
Unlikely to provide law clarification combined with tax avoidance	2
Insufficient facts provided to determine if the case would provide law clarification	2
Not Part IVC litigation – not tax technical	3
Recent litigation on the same issue	2
Retrospective application	1
Special leave application opposed	1

MINISTER'S ANNOUNCEMENT OF 7 AUGUST 2006

On 7 August 2006 the Government released the Inspector-General of Taxation's report of his *Review of Tax Office management of Part IVC litigation*. The report looked at the Tax Office's administration of tax litigation arising from the appeal procedures of Part IVC of the *Taxation Administration Act 1953*.

The Inspector-General made recommendations to the Government for improving the test case funding program and the funding of taxpayers' costs where the Tax Office appeals against a court or tribunal decision. In response, the Minister for Revenue and Assistant Treasurer announced that the Government will be establishing a new review body, to be headed by the Treasury, to review the submissions of unsuccessful applicants for test case funding.

⁴ For further detail regarding funded cases, see Attachment 2.

⁵ For further detail regarding the reasons why funding was declined, see Attachment 3.

CHAPTER 2: PROSECUTIONS AND DECISIONS OF THE COURTS

PUBLIC DOCUMENTS RELEVANT TO THIS CHAPTER

The following documents are available from the Tax Office website www.ato.gov.au and are relevant to the Tax Office's management of the prosecution process:

- Tax Office Prosecution Policy, and
- Memorandum of Understanding with Commonwealth Director of Public Prosecutions.

TAX OFFICE PROSECUTION POLICY

Background

The Tax Office has systems and processes to detect, investigate and prosecute people who engage in behaviour which constitutes fraud and other offences relating to the tax system.

The Tax Office's role is to detect and investigate potential cases and to refer cases to the Commonwealth Director of Public Prosecutions (CDPP). The Tax Office also works with the Australian Federal Police and Australian Crime Commission to investigate criminal offences relating to the tax system. The CDPP's role is to decide whether prosecution action should proceed and to conduct the prosecutions.

The Role of the Tax Office as the investigating and referring agency

The Tax Office's decisions about whether to pursue investigations of suspected tax offences for referral to the CDPP are guided by:

- the Prosecution Policy of the Commonwealth
- the Tax Office Prosecution Policy
- the Memorandum of Understanding between the CDPP and ATO, and
- the Australian Government Investigation Standards.

The criteria that apply under these guidelines include such things as:

- the nature, extent and seriousness of the alleged offence;
- the availability of sources of evidence needed to prove the allegations;
- whether the offence relates to particular areas of compliance focus for the Tax Office;
- 'public interest' type considerations, including:
 - whether the application of a criminal sanction is the appropriate remedy, given the seriousness of the behaviour exhibited
 - the likely impact of prosecution action on the community's confidence in the administration of the tax system
 - the likely influence of prosecution action on compliance by other taxpayers.

The Role of the Commonwealth Director of Public Prosecution

The CDPP is responsible for conducting prosecutions in relation to Commonwealth offences, including tax related offences. However, the CDPP has authorised the Tax Office to conduct prosecutions of a routine or minor nature, including for example, offences relating to failure to lodge income tax returns, failure to comply with the Commissioner's evidence gathering powers and offences relating to the duties of registered and unregistered tax agents. The CDPP becomes involved in these types of prosecutions if the charges are defended.

The Prosecution Policy of the Commonwealth

All decisions on whether prosecution action should occur in relation to cases referred from the Tax Office to the CDPP are determined in accordance with the Prosecution Policy of the Commonwealth. The consideration of matters under the Prosecution Policy of the Commonwealth requires a determination as to whether:

- there is a prima facie case
- there are reasonable prospects of conviction, and
- the prosecution is in the public interest.

CHAPTER 3: APPEALS BY THE TAX OFFICE AGAINST ADVERSE DECISIONS OF THE COURTS

BACKGROUND

Decisions by the Tax Office to appeal a decision of a Court or Tribunal are guided by the statutory rules of the Courts and Tribunals about the making of appeals. In making a decision to appeal advice is widely sought internally and often externally to the Tax Office.

A robust decision making process exists to ensure that decisions are appropriate and defensible. This is documented in the draft law administration practice statement titled "Management of Decisions of Courts and the Tribunals". This is expected to be finalised in November 2006 and in many respects simply restates rules that have been in place for some years. A copy of the draft practice statement has been made available to the Committee with this submission.

MAKING THE DECISION TO APPEAL

Apart from administrative law and debt collection matters a decision to appeal is made by an officer at the Senior Executive Service Band 2 level. To ensure that proper analysis and consideration has been undertaken, an Adverse Decision Report must be prepared in all instances where a wholly or partly adverse decision is handed down. The Adverse Decision Report provides a corporate record of the consideration of the decision about whether an appeal should be made. This document will incorporate the views of the litigation team, including the Legal Services officer, the Business Line officer, tax counsel and any views from external solicitors or counsel.

The following matters are considered before a decision is made on whether to appeal a decision:

- an analysis and commentary on any potential errors of fact or law contained in the decision,
- an analysis of any basis on which an appeal is justified:
 - for an adverse decision of the AAT, whether a question of law involved in the decision is sufficiently significant to justify an appeal to the Federal Court
 - for an adverse decision of the Federal Court the areas of the decision that would justify an appeal to the Full Federal Court
 - for an adverse decision of the Full Federal Court whether there is a question of sufficient public importance that would give the Commissioner reasonable prospects of securing the grant of Special Leave by the High Court
 - if it is considered that an appeal is justified, identification of the question of law and/or grounds of appeal that should be relied on.
- whether the decision is inconsistent with the published Tax Office view of the law and there are reasonable grounds for arguing that it is wrong,
- where appropriate, commentary on the conduct of the litigation by the Tax Office, and

- the views and perspectives of relevant officers from the Tax Office business lines and centre of expertise or tax counsel, as well as the Australian Government Solicitor and external counsel.

The Commissioner does not appeal unless there are good reasons for doing so. Adverse Decision Reports set out sufficient detail to satisfy the decision maker that all the implications of the decision have been considered.

CHAPTER 4: INCOME TAX REFUNDS

INTRODUCTION

Refunds are one of the three possible end results flowing from the lodging of a tax return, and occur in approximately 78% of cases. The other two results are a debit assessment (18% of cases) or a nil balance assessment (4% of cases). Nil balance assessments arise where the correct amount of tax has been paid or nil tax is payable and none has been paid in advance.

The calculation of refunds involves a number of steps. First, taxable income is calculated:

$$\text{Taxable income} = \text{Gross assessable income less allowable deductions and losses}$$

Taxable income is then used to derive four amounts:

- Gross tax payable, calculated from the legislated tax scales
- Medicare levy, calculated at one of two rates
- Medicare levy surcharge, calculated at 1% of taxable income for those on higher incomes without adequate private health insurance
- Higher education repayments, calculated in accordance with legislated percentage scales.

Then tax offsets are calculated, up to the amount of gross tax payable, which allows the calculation of net tax:

$$\text{Net tax} = \text{Gross tax less allowable tax offsets, plus Medicare levy and surcharge}$$

Then the result is calculated:

$$\text{Result} = \text{Net tax plus any Higher Education repayments less credits and refundable tax offsets}$$

If the result is negative a 'Refund' is paid. If positive, a debit assessment is issued. If zero, a nil balance assessment is issued.

PAYG WITHHOLDING

The Pay As You Go Withholding - PAYG(W) - system requires that amounts be withheld and remitted to the Tax Office by payers (employers) from certain payments to payees (individuals) to cover end of year tax liabilities. For the majority of taxpayers the payer withholds this amount based on withholding schedules prepared by the Tax Office.

The withholding schedules are built on the basis of gross income, that is, a tax instalment deduction is withheld according to the level of gross income the employee has earned in the relevant time period.

The withholding schedules do not result in a “precise” collection over the income year as they do not account for deductions or tax offsets. In addition, the schedules have “built-in” a very small amount of over withholding. This results in taxpayers receiving a refund of amounts previously collected by their employer (payer).

REFUNDS FROM INDIVIDUAL RETURNS

We have undertaken analysis of individual returns generating a refund for the 2003-04 tax year, that were lodged during 2004-05.

Total refunds paid amounted to \$15.1 billion with \$1.4 billion arising from the processing of late-lodged prior year returns (i.e. 2002-03 and earlier years). The refunds amount of \$13.7 billion for the 2003-04 year was paid to 8.35 million taxpayers.

These refunds consisted of two major components. The first was a true refund of monies already paid by the taxpayer, either through various withholdings, the main one being Pay As You Go Withholding (PAYG-W) from salary and wages, or through Pay As You Go Instalments (PAYG-I) direct from the taxpayer. This amount refunded totalled almost \$9.9 billion out of \$71.5 billion withheld, or 13.9%.

The second component consisted of payments of Refundable Tax Offsets, Family Tax Benefit and other credits that accrued to the taxpayer, but which had not previously been subject to a withholding from taxpayer income. Since the taxpayer did not contribute these amounts, they are not true ‘refunds’, but they are nevertheless included in the definition.

In regards to the refund population, we found the following broad patterns:

- there were 771,000 refund taxpayers (9.2%) with no withholding from salary and no instalments. These received 5.5% of the total refund amount (Group N in the table below).
- there were 3.023 million refund taxpayers (36.2%) who initially had a shortfall of withholding or instalment payments, calculated on gross income. These received 40.9% of the total refund amount (Group S in the table below).
- there were 4.558 million taxpayers (54.6%) who had an excess of withholding credits or instalment payments *before* the application of deductions, offsets or other benefits. These received 53.6% of the total refund amount (Group E in the table below).

CAUSES OF REFUNDS

We have analysed the refunds from the 2003-04 returns in more detail in order to give the Committee an understanding of the causes of refunds. Although we have not analysed the \$1.4 billion flowing from returns lodged in respect of prior years, the same principles apply, and it is likely that the same patterns would emerge from any such analysis.

We have calculated that there were five main causes of the refunds issued:

- 1 Application of deductions and losses to reduce taxable income - estimated at \$5.23 billion, or 38.3% of the total refund amount.
- 2 Taxpayer circumstances not aligning with the assumptions built into the withholding schedules - estimated at \$3.84 billion, or 28.1% of the total. While some of the reasons for this misalignment are canvassed in Attachment 4, we are continuing studies to understand this situation better.
- 3 Application of refundable tax offsets and credits - \$2.69 billion, or 19.7% of the total.
- 4 Payment of Family Tax Benefit - \$1.1 billion or 8.1% of the total.
- 5 Application of tax offsets to reduce tax liability - estimated at \$0.8 billion, or 5.8% of the total.

The detail of these calculations is presented in Attachment 4, and the following table shows the breakdown of refunds for each of the three abovementioned groups by cause:

	Group N (no withholding on salary, or instalments)	Group S (initial shortfall of credits from withholding & instalments)	Group E (initial excess of withholding credits or instalments)	Total
	\$bn	\$bn	\$bn	\$bn
1. Deductions & losses	n/a	3.369 24.6%	1.864 13.6%	5.233 38.3%
2. Withholding mismatches	n/a	n/a	3.834 28.0%	3.834 28.0%
3. Refundable tax offsets & credits	0.535 3.9%	1.837 13.4%	0.322 2.4%	2.694 19.7%
4. Family Tax Benefit	0.212 1.6%	0.387 2.8%	0.515 3.8%	1.114 8.1%
5. Tax offsets	n/a	n/a	0.797 5.8%	0.797 5.8%
Total	0.747 5.5%	5.593 40.9%	7.332 53.6%	13.672 100%

Deductions and losses

Deductions reduce assessable income. As mentioned above PAYG(W) is calculated on gross income. This interaction means that deductions will often cause over-withholding. We have estimated this at \$5.23 billion, or 38.3% of the total refund amount. This is the biggest component.

In 2003-04 the amount included in tax returns for deductions and losses was \$52.6 billion, or approximately 16% of gross income.

Deductions do not flow directly into refunds. They are subtracted from gross income to derive taxable income, on which tax, Medicare levy (and surcharge) and higher education repayments are calculated. Their effect on refunds thus takes into account the marginal tax rate of the individual and residual tax payable. We have estimated that the \$52.6 billion claimed resulted in \$5.23 billion of refunds.

Over withholding

We have estimated this at \$3.84 billion, or 28.1% of the total refund amount.

The withholding schedules are based on a person holding the same income level over the whole income year. Where an individual has 'lumpy' income for the year, the amount of tax instalments withheld are unlikely to match the end of year liability.

Over-withholding may occur when:

- people who lose employment for a period or who recommence employment for only part of the year may not achieve the full-year marginal tax rate built into the withholding scales. If the same people also ask their employers to withhold extra for anticipated higher education liabilities, this may further increase their refund.
- some people who have a second job and declare it to their employer will have a flat rate withholding that may be higher than their end of year marginal tax rate. (Note that it is also likely that others with multiple jobs will not have enough withheld)
- people who are promoted during the year will have their withholdings increased, but the scales will assume that this income was received on a full-year basis, with a higher average tax rate
- other people have variable income that does not match the underlying assumptions built into the withholding scales.

Note that there are also reasons why individuals may not have enough tax withheld through the withholding schedules.

REFUNDS PAID OVER TIME

The following table shows refunds over time, expressed as a percentage of total income tax.

Year	Gross PAYG ⁽¹⁾	Gross other	Individuals	% of total
	withholding ⁽²⁾	individuals ⁽³⁾	refunds	income tax take for individuals ⁽⁵⁾
	\$m	\$m	\$m	%
1995-96	56,628	10,078	8,285	14.2%
1996-97	61,513	11,820	8,808	13.7%
1997-98	66,155	12,119	9,525	13.9%
1998-99	71,758	12,539	10,311	13.9%
1999-00	77,162	13,370	10,946	13.8%
2000-01	74,477	13,231	10,989	14.3%
2001-02	79,599	16,236	11,078	13.1%
2002-03 ⁽⁴⁾	84,922	17,370	12,193	13.5%
2003-04 ⁽⁴⁾	90,285	19,875	12,967	13.3%
2004-05 ⁽⁴⁾	98,013	22,440	15,115	14.3%

Notes

This information was sourced from the *Australian Taxation Office Annual Report 2004-05, Page 39, Table 2.5*. For simplicity, we have compared refunds to collections in the same financial year.

(1) Gross pay as you earn (PAYE) collections up to 1999-00 and gross PAYG withholding collections from 2000-01. Gross PAYG withholding includes amounts withheld from salaries and wages and other payments that were subject to PAYE withholding arrangements or the prescribed payments or reportable payments systems before 1 July 2000, plus tax file number and Australian business number withholdings from 1 July 2000. From 1 July 2001 it includes dividend, interest, royalty, and mining withholding taxes which, in previous years, were part of 'other'.

(2) Includes Higher Education Contribution Scheme collections.

(3) Includes Child Support trust account receipts for years 1995-96 to 1997-98.

(4) Includes private health insurance, family tax benefit and baby bonus expense items.

(5) *Individuals refunds / (Gross PAYG withholding + Gross other individuals - Individual refunds)*

CHILDCARE REBATE AND PAYG(W)

The income tax legislation specifically precludes parents varying their PAYG(W) to take into account a possible future entitlement to the 30% childcare rebate.

RELEVANT RESEARCH

The Tax Office commissioned market research in 2000 to gauge community reaction to possible ideas for simplifying the administration of the personal tax system. At Attachment 5 is the Table of Contents and Chapter 6 of the report, which deals with the community's understanding of and attitudes towards refunds. The full report can be accessed via the Tax Office website at the following location:

www.ato.gov.au/individuals/content.asp?doc=/content/16577.htm

CHAPTER 5: REMUNERATION OF TAX OFFICE EXECUTIVES

BACKGROUND

At the Tax Office performance pay is available to senior executives (SES) and Executive level 2 employees (EL2). In 2004-05 there were 251 SES officers and 1,687 EL2 employees considered eligible for performance pay.

Performance pay is available in recognition of outcomes achieved and leadership behaviours displayed during the course of the year.

The first 5% of performance pay forms part of the total salary an SES or EL2 officer is entitled to receive if they perform their job effectively, and is therefore referred to as 'salary at risk'. Where performance is assessed as being more than fully effective, the individual is entitled to additional performance pay.

PERFORMANCE PAY NOT LINKED TO REVENUE/AUDIT WORK

Performance pay is not linked to revenue collections or audit work. SES and EL2 officers are entitled to performance pay if their performance is assessed at a high enough standard against agreed performance measures. All performance guidelines and training provided for Tax Office staff has been reviewed to ensure there are no linkages between revenue targets and individual performance agreements in any of our training and performance management material.

We note that at the 22 June hearing the Ombudsman gave evidence that his review of this matter concluded that the evidence they saw would not suggest that there is any direct connection.

PERFORMANCE PAY ACROSS THE AUSTRALIAN PUBLIC SERVICE

Whilst meeting Australian Public Service (APS) requirements, the Tax Office's performance pay system has been tailored to meet organisational needs. For this reason, no agency of similar size in the APS has an identical performance pay system. Some agencies may provide performance pay through an individual Australian Workplace Agreement (AWA).

The 2001 Management Advisory Council report on performance management identified that there was a diversity of approaches to performance-related pay, without suggesting any one model was better than the others⁶.

⁶ Performance Management in the APS: A Strategic Framework, 2001. Available at: <http://www.apsc.gov.au/publications01/performancemanagement.htm>

APS employees whose pay was linked to an assessment of their performance were asked in the 2004/05 APS State of the Service Report⁷ about how this link was made. Whilst the majority of respondents identified that they could advance through a salary range subject to fully competent performance, 24% of respondents identified that they were eligible for a one-off performance-linked bonus.

SES AND EL2 PERFORMANCE APPRAISALS

Performance appraisals occur at mid year and at annual appraisal time following the end of year performance discussions.

The purpose of both the mid year and annual appraisal discussion is to:

- evaluate performance in achieving agreed business outputs (WHAT)
- evaluate how the officer demonstrated the expected behaviours in achieving those outputs (HOW)
- discuss learning and development needs, and
- identify the mutual expectations of the working relationship and record them using a Personal Plan, which has now been included as part of the Performance & Development Agreement.

Managers provide ratings for both “WHAT” and “HOW” during the annual appraisal discussion. Both ratings are equally important. This rating is used to determine performance pay.

⁷ State of the Service Report 2004-05. Available at: <http://www.apsc.gov.au/stateoftheservice/0405/c8c.htm#81>

SES AND EL2 PERFORMANCE RATINGS

A rating scale of 1 to 5 is used for performance appraisal ratings:

Rating	Definition	Description
5	Exceptional	A rare level of performance, unlikely to be sustained over extended appraisal periods.
4	Superior	Achievement has been consistently high on the range of indicators, behaviours, competencies and any leadership role throughout the appraisal period, well beyond Fully Effective level.
3	Satisfactory/Fully Effective	Good and meritorious achievement.
2	Borderline/Entry	New to the job, developing required skills and performance level; OR Performance has slipped below standard detailed in performance agreement for either business outputs or behaviours (plan is in place to address issues).
1	Unsatisfactory	Continued failure to achieve expected standard. Inefficiency process is in place.

EL2 PERFORMANCE PAY OUTCOMES

The following table shows performance pay outcomes based on ratings for “What” and “How”.

Rating for ‘What’	Rating for ‘How’	Performance Pay
5	5	15%
5	4	12.5%
4	5	12.5%
4	4	10%
5	3	10%
3	5	10%
4	3	7.5%
3	4	7.5%
3	3	5%
2 or 1	Any rating	0%
Any rating	2 or 1	0%

SES PERFORMANCE PAY OUTCOMES

All SES are eligible for performance pay at the end of each financial year where their performance has been rated as fully effective, superior or exceptional. SES Band 1 officers may receive performance pay of either 5, 10 or 15%. SES Band 2 officers are entitled to similar specified amounts of performance pay based on whether their performance has been rated as fully effective, superior or exceptional.

As with EL2 employees, the first 5% of performance pay forms part of the total salary the senior executive is entitled to receive if they perform their job effectively.

AMOUNTS OF PERFORMANCE PAY

For 2004-05, and paid in 2005-06:

- 235 senior executives out of a possible 251 received performance pay totalling \$2,278,482, and
- 1,588 EL2 employees out of a possible 1,687 received performance pay totalling \$9,351,229.

The table below shows the performance payments made by the Tax Office for 2004-05 and paid in 2005-06, by classification.

Level	Number of recipients	Percentage rate/qualifying level	Number receiving	Average performance pay
Executive Level 2	1,687	0	99	\$5,543
		5	682	
		7.5	473	
		10	402	
		12.5	28	
		15	3	
SES Band 1	226	0	16	\$8,586
		5	79	
		10	131	
		15	0	
Level	Number of recipients	Percentage rate/qualifying level	Number receiving	Average performance pay
SES Band 2	25	Less than fully effective	0	\$13,520
		Fully effective	5	
		Superior	20	
		Exceptional	0	

CHAPTER 6: ACTIVE COMPLIANCE

INTRODUCTION

Active compliance includes advisory, verification, enforcement and prosecution activities that can be undertaken in the field, by telephone or by letter or, in some cases, without any taxpayer contact. The aim of active compliance activities is to deter non-compliance and ensure that taxpayers who comply with their obligations are not at a personal or commercial disadvantage relative to those who do not want to comply.

Accordingly, it is the indirect effects of our active compliance activities that are more important than the direct results (revenue and penalties). While we are exploring whether there are better measures of effectiveness, it is worth noting that overall collections in 2005-06 exceeded Budget forecasts.

We actively manage taxpayer compliance with a number of revenue products that make up the different elements of the tax system, with the main ones being income tax (including capital gains tax), GST, superannuation and excise. Other revenue products include fringe benefits tax, luxury car tax, petroleum resource rent tax and wine equalisation tax.

The nature and level of risk, and the amount of revenue at risk, will vary according to the type of product and the particular circumstances of the taxpayers impacted. We separate our taxpayer population into broad market segments so that we can better understand risks, and so that we can differentiate our responses according to the level of risk presented and the characteristics, circumstances and capabilities of different taxpayers within each of those market segments.

RESULTS FOR 2005-06

In 2005–06 we raised \$6,244 million in total liabilities (tax, penalties and interest) from our active compliance work. While large businesses continued to make the largest contribution to active compliance results, the results also reflect our increased focus on the upper end of the small to medium enterprises market segment.

Our active compliance results include a range of activity types. These include activities to secure lodgments, pre-issue activities to prevent incorrect refunds or payments, and post-issue activities such as reviews and audits.

The outcome of some active compliance activity is to protect the revenue base, for example, by reducing (where appropriate) carried forward losses and potential rental and work-related expense claims. In 2005-06 our active compliance activities in these areas protected an estimated \$1.7 billion in revenue.

OUR APPROACH

How intensively we scrutinise a taxpayer's affairs depends on the level of risk to the effective operation of the tax system. Where we identify a serious or widespread risk, we increase our level of attention to that risk. We use a range of mechanisms to identify and evaluate emerging risks. For instance, large businesses come under intense scrutiny because of the size and complexity of their transactions and the scale of their contribution to revenue.

At the same time, we differentiate between taxpayers who are trying to do the right thing and those who are not. Our intent is to influence the behaviour of taxpayers in a way that will encourage voluntary compliance. For this reason, we do not attempt to audit everyone. Our audit program is directed more at addressing outliers and sending a strong message to others in the community that there is a high risk of being caught if they choose not to comply. These audits also help us sharpen our understanding of the particular risks involved.

We seek a balance between help and education activities aimed at ensuring that taxpayers understand and meet their obligations, and overt action aimed at identifying and correcting deliberate non-compliance. Depending on their circumstances and levels of culpability, taxpayers may receive help, have their affairs reviewed, be subject to audit, or be prosecuted where deliberate acts of evasion or fraud are involved,

RETURN ON INVESTMENT

At the JCPAA public hearing on 22 June 2006, the Committee asked for estimates of expected returns per million dollars of extra resources being applied by the Tax Office to compliance activities in various market segments.

The average return on investment (ROI) for our overall active compliance program for 2005-06, based on collections, is a ratio of 6:1. A breakdown of the ROI by market segment for the same year is as follows:

Large Businesses	15:1
Small and Medium Enterprises	6:1
Micro Businesses	3:1
Government	6:1
Not-for –profit	5:1
Individuals	4:1

However, it is emphasised that these results represent the average ROI from a diverse mix of active compliance responses tailored to particular risks. These activities can range from help and education strategies to tax investigations related to criminal activity. The expected ROI for any active compliance activity will therefore vary according to the nature of the risk, the amount of revenue at risk, and the mix of mitigation strategies employed.

In some limited circumstances the Tax Office estimates the direct level of additional tax (including penalty and interest) which may be raised as a result of additional direct investment

in certain focus areas. Recent examples of this include Operation Wickenby and the Compliance Challenges commitments, both of which were aimed mainly at ensuring ongoing community confidence in our administration of the tax system and involved relatively moderate revenue outcomes.

CHAPTER 7: RULINGS

PUBLIC DOCUMENTS RELEVANT TO THIS CHAPTER

The following documents are available from the Tax Office website www.ato.gov.au and are relevant to the Tax Office's management of the rulings process:

- Private ruling application form (non-tax professionals)
- Private ruling application form (tax professionals)
- TR 2006/10: Income tax, fringe benefits tax and product grants and benefits: Public Rulings
- TR 2006/11: Income tax, fringe benefits tax and product grants and benefits: Private Rulings

RECENT PUBLIC RULINGS

At the JCPAA public hearing on 22 June 2006, the Committee asked for a copy of a draft public ruling on private rulings. On 4 October 2006 this was finalised and released as Taxation Ruling 2006/11. A copy has been made available to the Committee with this submission and is available on the internet via the Tax Office Legal Database at law.ato.gov.au.

On 4 October 2006 the Tax Office also released Taxation Ruling 2006/10 in relation to public rulings.

Both TR 2006/10 and TR 2006/11 provide guidance on the rulings system following the enactment of the *Tax Laws Amendment (Improvements to Self Assessment) Act (No. 2) 2005*. For example, guidance is offered on:

- what constitutes a private or public ruling
- the status and binding effect of a private or public ruling
- the effect of inconsistent rulings, and
- the status of a private or public ruling following a rewrite of the law.

GENERAL INFORMATION

Private rulings – Tax Office process

Private rulings are binding on the Commissioner but not the taxpayer. In determining a request for a private ruling, a mandatory process requires the officer handling the ruling request to access our precedential ATO view database to ensure that they are applying the Tax Office view of the law to the facts of the particular ruling request. In all cases the use of the correct Tax Office view by the officer handling the case is checked and approved by an accredited officer.

The precedential view database includes public rulings and interpretative decisions along with a range of other approved 'Tax Office view' documents. The requirement to apply the 'Tax Office view' in all cases ensures that we are consistent in our application of the law to the same set of facts regardless of the source of the private ruling request.

In situations where there is no existing view on a particular set of facts, the case officer is required to escalate the case to an appropriate senior tax technical officer so that a 'Tax Office view' can be formulated in relation to the specific facts of the case.

If the case officers are concerned about the correctness of the 'Tax Office view' they are required to escalate the matter so that the position can be reviewed.

Impact of public rulings on private rulings

Income tax rulings

As a general principle, an entity may always choose to rely on a public ruling that applies to them and may choose to rely on a private ruling that specifically addresses their circumstances (assuming it still applies to them). So, if there is an inconsistency between a later applicable private ruling and an earlier public ruling, the entity may choose which ruling is most beneficial to them.

However there are special rules which limit the ability to rely on a private ruling if it is inconsistent in some respect with a later public ruling. If the private ruling is inconsistent with a later public ruling, the earlier private ruling is taken not to have been made and cannot be relied on by the entity if:

- the income year or other period to which the private ruling relates has not begun, or
- the scheme or transaction to which the private ruling relates has not begun to be carried out.

This allows the correction of an erroneous private ruling, but only where the entity has not already entered into the scheme or the relevant income year or accounting period has not commenced.

Indirect tax rulings

If a GST private ruling is given to a taxpayer and a subsequent GST public ruling is issued which conflicts with the GST private ruling, the GST public ruling will prevail from the date of issue of the GST public ruling. This means that the business will not be subject to the GST that is attributable to the period prior to the date of effect of the GST public ruling.

If a GST private ruling is issued which conflicts with an earlier GST public ruling then the GST private ruling will prevail. This means that the business is not subject to GST in relation to the matter and for the period covered by the GST private ruling.

Impact for entity following a private ruling once it stops applying

A private ruling only binds the Commissioner if the ruling applies to the entity for an income year and that entity relies on the ruling. Therefore, an entity cannot rely on a private ruling for income years or periods that are not covered by that private ruling as the ruling does not apply.

As an option, the entity can apply for a new private ruling at any time to cover a later income years or periods not covered by the earlier private ruling.

If an entity continues to follow a private ruling once it stops applying and there is a tax shortfall, the entity may be liable for penalties and interest, if the entity does not take reasonable care, or does not have a reasonably arguable position for an income tax matter. This means that there would not be a penalty where it was reasonable for the taxpayer to have relied on the ruling.

What stops ruling shopping?

The Tax Office has a single computer system on which all private ruling requests are processed. This centralised system enables case officers to see if other ruling requests on the same issue from the same applicant are in course. The centralised system also provides direct access to the precedent database to ensure that the same outcome is applied to the same facts regardless of who the applicant may be. This process ensures that regardless of when, where or from whom a private ruling request is received it is managed on a single computer system using a common precedent data base containing the 'ATO view' and the same outcome is applied to the same set of facts.

RESOURCES INVOLVED IN THE PREPARATION OF RULINGS

Private rulings

Private rulings provide taxpayers with an understanding of how a particular transaction would be viewed by the Tax Office. The private ruling is binding on the Commissioner and the Commissioner must not apply a provision covered by the ruling in a way that is inconsistent with the private ruling to the detriment of the taxpayer. The private ruling is binding so long as the taxpayer provides the tax office with a full and true disclosure of the material facts relevant to that transaction and the transaction is implemented in the way set out in the private ruling.

Simple forms for requesting a private ruling are available from the Tax Office website. Tax agents who seek private rulings on behalf of their clients are generally expected to explain their reason for uncertainty about the matter.

The process of providing a private ruling to an applicant involves an initial examination of the request to determine the actual nature of the request prior to it being referred to the appropriate area or specific tax officer for the private ruling to be written.

Prior to making a decision on the outcome of the private ruling request the case officer is required to ensure that they have all the information necessary to make the ruling. This

sometimes means that they need to contact the applicant to seek further information to be able to make the private ruling.

Where a private ruling request involves a complex set of facts or is not covered by an existing precedential ATO view the case officer must seek specialist advice from a centre of expertise or the tax counsel network in order to ensure the advice provided in the ruling reflects the Tax Office's view of the law in relation to the specific facts involved. All private rulings must be authorised by an accredited authorising officer before being issued.

All private rulings are published on the Tax Office website after all material which would allow the applicant to be identified has been removed.

The 2004-05 Annual Report shows that Provision of Advice and Assistance accounted for 10% of Tax Office's staffing commitments. Of the total 20,797 staff, 2091 tax officers were engaged in providing advice and assistance. In 2004-05, approximately 387 full time equivalent staff were involved in the preparation of private rulings. Of this number, approximately 37 full time equivalent staff were involved in the preparation of material considering matters of precedence. This includes the provision of specific private rulings or material on which these and future rulings will be based.

Public rulings

Public rulings attempt to guide the taxpayer on the Tax Office's views on the application of the law in an area where there may be uncertainty. They bind the Commissioner but not the taxpayer – they carry no adverse consequences for taxpayers.

The process for developing public rulings involves input and consultation with representative bodies and industry partnerships, where appropriate, and respected tax experts in the community. This is in addition to our rigorous rulings panel processes whereby experienced practitioners and academics inject legal, practical and commercial implications into our deliberations.

Attachment 6 contains a list of current and past external experts on our public rulings panels.

In 2004-05, approximately 219 full time equivalent staff were involved in the preparation of public rulings.

NUMBER OF TAX RULINGS BY TAX TYPE

Private rulings

Income year	Income Tax (inc FBT)	Excise	GST (inc FBT)	Superannuation	Total
2006	9,492	190	2,711	1,659	14,052
2005	9,501	153	3,125	1,608	14,387
2004	9,636	145	3,568	1,719	15,068
2003	10,865	23	3,954	895	15,737
2002	8,790	30	5,453	763	15,036

Public rulings

Refer Attachment 7.

REPEALED INOPERATIVE PROVISIONS

The *Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006* (the Act) received Royal Assent on 14 September 2006. At the Committee hearing on 22 June 2006 the Committee referred to Treasurer's press release No. 64 of 2006 that mentioned approximately 200 public rulings would require amendment or withdrawal as a result of the legislation. The Tax Office has now completed a more intensive review of income tax rulings and the figure is closer to 300.

It is anticipated that by the end of 2007:

- approximately 70 affected income tax public rulings that no longer have application will have been withdrawn, and
- a further 70 income tax public rulings that require revision will have been updated and re-issued.

The remaining rulings require significant amendment or even redrafting. These revisions, while being priority work, will take place in conjunction with the development of public rulings and the ongoing work required to maintain the currency of our legal database as a result of law improvement processes.

In the meantime, where the old law has been substantially changed, the part of the public ruling dealing with the repealed provision ceases to apply.

Changes to the Tax Office Legal Database to assist users in identifying the affected rulings are currently being developed in consultation with professional bodies.

The Tax Office has also identified several hundred sales tax rulings that require withdrawal following the Act's repeal of Sales Tax law. These products will be withdrawn over the course of the 2007 calendar year.

CHAPTER 8: MICRO BUSINESSES

REVENUE CONTRIBUTION

The Compliance Program 2006-07 states that the tax paid by micro businesses makes up around 11% of the total tax collected. Of the various taxes, micro businesses contribute:

- 13% of all income tax from companies
- 67% of all other income tax
- 25% of all goods and services tax
- Less than 1% of all wine equalisation tax and luxury car tax
- Less than 1% of all fringe benefits tax
- Less than 1% of all excise.

On behalf of their employees, micro businesses also contribute a further 7% of total tax collected, through the amounts they withhold from payments to their employees.

The following table from Taxation Statistics 2003-04 provides the amount of net company tax by industry type and company size for the 2003-04 tax year. Comparable information for the 2004-05 income year will not be available to the Tax Office until November 2006 and not completely collated, assured and published until April 2007. The total net company tax derived from incorporated micro businesses was \$5,458 million.

Industry ²	Loss/nil ³ \$m ⁴	Micro \$m	Companies			Total \$m
			Small \$m	Medium \$m	Large \$m	
Agriculture, forestry & fishing	0	154	102	98	201	556
Mining	14	18	31	139	2,812	2,813
Manufacturing	2	277	534	950	2,687	4,450
Electricity, gas & water supply	0	5	4	58	88	153
Construction	0	383	380	315	237	1,315
Wholesale trade	4	181	435	793	1,580	2,993
Retail trade	0	241	275	313	1,475	2,306
Accommodation, cafes & restaurants	0	75	96	68	33	272
Transport & storage	0	114	119	159	412	804
Communication	0	18	17	38	1,819	1,891
Finance & insurance	27	2,233	928	1,224	8,427	12,840
Property & business services	7	1,385	832	768	817	3,810
Education	0	24	16	20	0	60
Health & community services	0	161	60	47	37	306
Cultural & recreational services ⁵	0	73	48	52	248	422
Personal & other services	0	65	55	42	28	210
Other ⁶	4	29	39	69	36	177
Total	59	5,458	3,972	5,150	20,737	35,375

1 Only taxable companies would have net tax amounts. Taxable companies are defined as companies with net tax of more than \$0.

2 The industry groups are classified based on the ANZSIC system. Fine industries included under these broad industry groupings are listed in company tax detailed table 4. There is a complete listing of all fine industries included under each broad industry group in Business Industry codes 2004.

3 Loss/nil companies (companies with total income equal to or less than \$0) may still be liable for net tax because these companies may still have net capital gains, other assessable income and other income items reported as 'reconciliation items' on their company returns.

4 A \$0 net tax indicates an amount of less than \$500,000.

5 Includes sports.

6 Includes companies lodging under the 'Nil company returns' code (code: 98000 in Business Industry codes 2004) which includes non-taxable companies or companies with nil company returns - no income, expense or balance sheet data present; companies that did not state their industry; and/or companies registered under the government administration and defence industry code.

CHAPTER 9: TAX AGENTS

The Tax Office's first submission to the Joint Committee of Public Accounts and Audit's inquiry into a range of taxation matters provided information on the role of tax agents in the system as well as Tax Office strategies on "making it easier for tax agents". This chapter expands on that information and provides additional material following questions received at the Committee's public hearing on 22 June 2006.

INTRODUCTION

The tax agent segment is the core element of the wider tax practitioner community, which includes bookkeepers, legal practitioners, software developers and superannuation fund auditors.

Tax agents, along with bookkeepers and legal practitioners, are legally authorised to provide advice to taxpayers, to otherwise deal with the Tax Office on behalf of taxpayers or to prepare and lodge documents for taxpayers.

We recognise tax practitioners play an essential role in helping to maintain the integrity of the tax system that is fundamental to supporting our Australian way of life. Tax practitioners are valued contributors to the design of the administrative arrangements associated with the tax system. We work hard to further develop an open and constructive relationship with them, recognising practice management issues in our administrative design.

Tax agents play a critical role in the efficient and effective operation of the revenue system, and its integrity, through the influence they have on their clients. This influence is crucial to the success of the self-assessment system. We expect:

- taxpayers to fully disclose their tax-related matters to their tax agents, and
- tax agents to fulfil their professional and legal obligations and to facilitate the lodgment of their own and their clients' complete and accurate tax returns and forms.

We recognise that most tax agents are competent, ethical professionals who help their clients meet tax obligations and meet their own business and personal tax obligations. We work closely with agents and their professional bodies, and the Tax Agents' Boards, to ensure high standards of integrity in order to maintain community confidence and protect consumers.

We acknowledge that tax agents have a commercial relationship with their clients, and expect them to act in a professional manner, competently show regard for the law and comply with their obligations.

TAX AGENT SERVICES

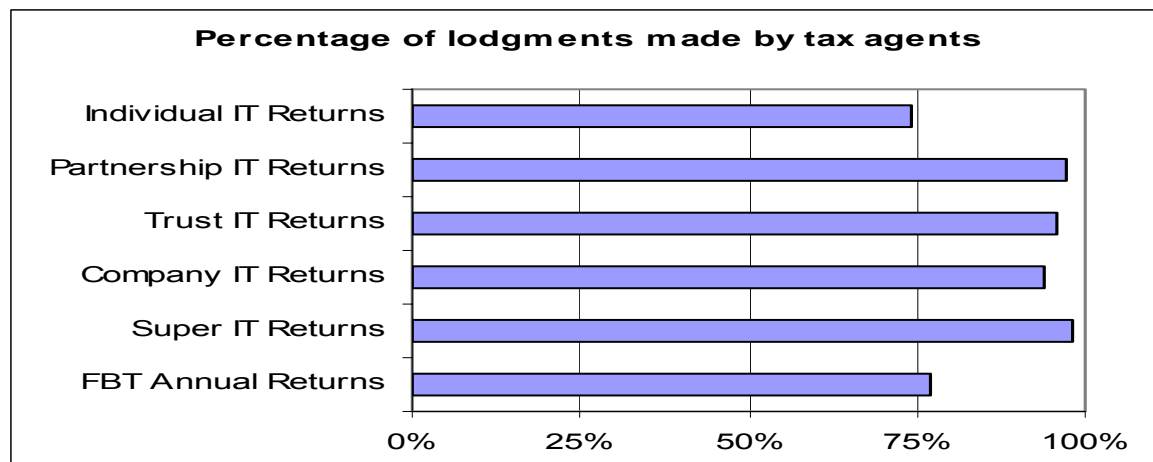
There are about 26,000 registered tax agents in Australia. Collectively, they lodge around 74% of income tax returns for individuals and over 95% of returns for businesses. Many tax agents

also provide financial advice and/or act as independent auditors of self-managed superannuation funds.

Tax agents prepare and lodge and provide information on:

- income tax returns
- business and instalment activity statements
- fringe benefits tax returns
- superannuation regulatory returns from self managed superannuation funds
- reasonable benefit limit forms
- eligible termination payment forms
- member contribution statements from superannuation funds and self managed funds
- pay as you go withholding and other withholding lodgment obligations, and
- other forms supporting the operation of the Australian revenue system

For the 2003–04 tax year, the percentage of taxpayers using tax agents is summarised in the chart below.



Approximately 300,000 individuals move from tax agents to preparing their own returns each year, and vice versa with the overall balance remaining fairly constant.

The main reasons taxpayers use tax agents include:

- the complexity of their tax affairs
- the complexity of the tax system
- a lack of confidence in dealing with the tax system
- a perception they are 'safer' if they use an agent
- an expectation it will minimise their tax, and
- a growing community trend to pay for products and services.

TAX AGENT DEMOGRAPHICS

As at July 2006, there were 26,378 total registrations (including branches). This represents an increase of 2.4% since February 2005. This included:

- 21,789 active agents (registered agents with ≥1 client)
- 11,850 active agents with 100 or more clients
- 19,892 active agents who have lodged returns for the current year, or are a new agent.

The activity level of tax agents may be defined in various ways and will depend on the purpose for which the information is being provided. The word 'active' may be broadly defined as those agents who have clients. Additional criteria may be added to include only those agents who have lodged returns for the current year, or are a new agent.

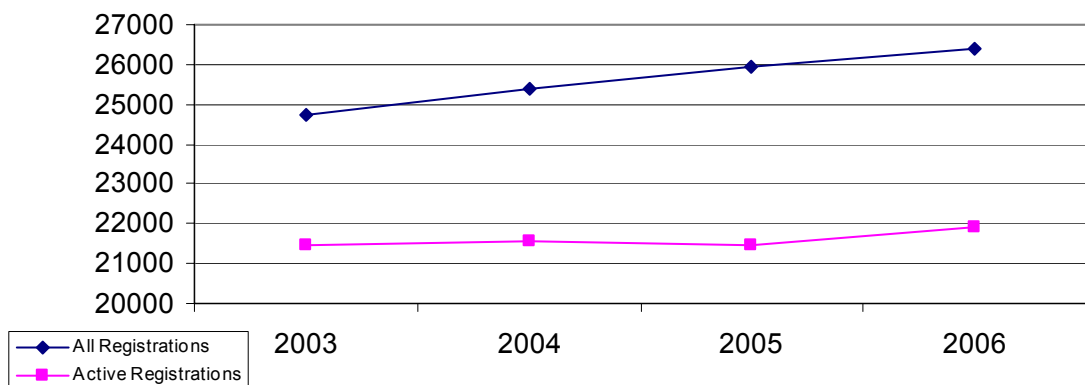
The majority of tax agents are linked to multiple registrations. A link is defined as a controlling interest as either an individual, partner, executive officer or nominee of more than one tax agent registration number. Tax file numbers have been used to determine how many tax agents are linked to more than one tax agent registration.

Of the 10,909 tax agent tax file numbers linked to more than one tax agent registration:

- 61% (6,623) of tax agents have an interest in 2 tax agent registrations
- 32% (3,451) of tax agents have an interest in 3 tax agent registrations
- 1% (107) of tax agents have an interest in more than 5 tax agent registrations

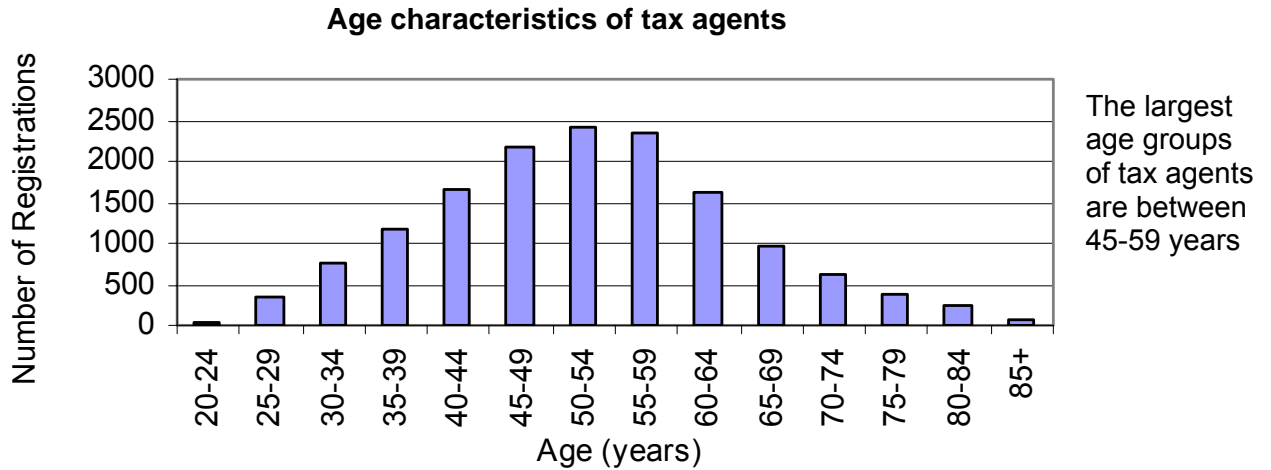
The number of all registrations has increased slightly over the previous 2 years. During the same period the number of active registrations has remained relatively steady.

Registration trends 2003 - 2006



The

The majority of individual active agents (≥ 1 client) are over 40 years old with 46% in the 45-59 years age bracket, with 42% aged 55 years and over.



In 2005, 17% of agents stated that they were planning to retire within 2 to 3 years (in comparison to 7% of accountants leaving their occupation each year). In 2003, 13% of tax agents indicated an intention to retire within the next 2 to 3 years. However these intentions have not translated into a comparable decrease in the agent registrations at this stage. We will continue to monitor trends in registration figures into the future, particularly with the triennial registration process due to occur in April 2007. Given the current age profile of tax agents, we expect to see retirement trends impacting on this segment within the next 5 to 10 years.

Taking into account the lead time of several years for individuals to develop the capability to meet tax agent registration requirements, it is important that we continue to work with the professional associations on strategies to attract new entrants into the tax profession

Some additional results of recent research on the tax practitioner industry are provided at Attachment 8.

Based on the number of registrations at July 2006, there were 14,935 active tax agent registrations in urban areas and 6,759 in non-urban. There were 24 active registrations where the location was unknown.

The table and figures below provide more detail of agent location as at February 2006:

central business district	7%
inner metropolitan	46%
outer metropolitan	22%
rural	15%
regional	10%

Fig 4: % registrations by state

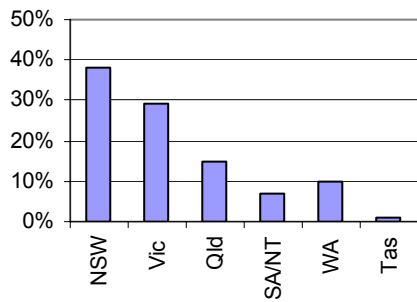
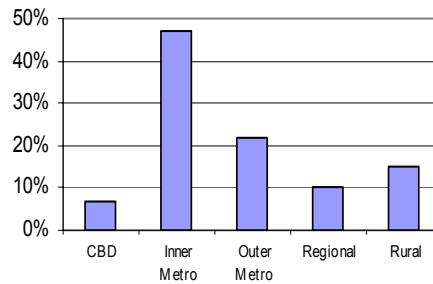


Fig 5: %registrations by location



To further understand and differentiate the tax agent market by client base, we define tax agents by tiers as follows:

Tier Category	Description
Top End	<p>This tier consists of the Top 4 accounting companies.</p> <p>Criterion applied to segregate these practices:</p> <ul style="list-style-type: none"> ▪ number of overall clients of the group⁸ > 9,000 ▪ large business and international clients represent greater than 9% of overall client base ▪ group's net tax 2001 liability was > \$1.1 billion ▪ group's net taxable income amount > \$8.5 billion
2nd Tier	<p>This tier represents those not covered by any other category who have the following characteristics:</p> <ul style="list-style-type: none"> ▪ number of overall clients of the sub-agent > 1,000 ▪ Large business and international client base is 10 or more ▪ net tax 2001 liability was >= \$10 Million
High Bulk Merchant	<p>A High Bulk Merchant is considered to be a practitioner that meets the following characteristics and is not covered by any other category:</p> <ul style="list-style-type: none"> ▪ Personal tax client base of greater than 1000 and ▪ 70% of total client base are Personal tax market
Personal Tax Focused	<p>Personal Tax Focused represent those not covered by any other category who have the following characteristics:</p> <ul style="list-style-type: none"> ▪ Personal Tax clients represent greater or equal to 70% of their client base
Medium Practice	<p>The Medium Practice tier represents those not covered by any other category who have the following characteristics:</p> <ul style="list-style-type: none"> ▪ total client base > 500
Small Practice	<p>The Small Practices tier represents those practices not covered by any other category and who have the following characteristics:</p> <ul style="list-style-type: none"> ▪ total client base <= 500
Micro Agent	<p>This includes all registrations with an overall client base (i.e. Individuals, partnerships, trusts, companies and super funds) of less than 100.</p>

⁸ The group in this context is not limited to the same primary agent number but all primary registrations that share some degree of commonality of practice name. The limitation to this approach is that in some cases a primary registration may be autonomous although they share the practice title.

Many tax agents are members of one or more of the professional associations. The associations have a role in bringing about significant improvements to the tax system by:

- providing expertise and information about the tax system
- shaping and leading debate on issues affecting the profession and the wider community, through advocacy and lobbying
- participating in consultations and providing submissions on technical and administrative issues, and
- providing a vehicle for two-way communication with the Tax Office.

The professional associations include:

- Certified Practicing Accountants Australia (CPAA)
- Institute of Chartered Accountants in Australia (ICAA)
- National Institute of Accountants (NIA)
- Taxation Institute of Australia (TIA)
- National Tax and Accountants Association (NTAA)
- Association of Tax and Management Accountants (ATMA), and
- Chartered Institute of Management Accountants.

The Tax Office does not have access to reliable data on the recognised professional association memberships of registered tax agents.

REGULATION OF TAX AGENTS

Tax agents are regulated by Tax Agent Boards which are independent statutory bodies constituted under the legislation. There is a Board in each state and each Board acts autonomously in the execution of its duties. Each Board consists of three members who are appointed by the Minister for Revenue and Assistant Treasurer. One member is an officer of the Tax Office and the other two members traditionally come from the legal and accounting professions. One of the non-Tax Office members is appointed as Chairperson of the Board.

The role of the Board is to administer the tax agent registration requirements contained in the legislation. The Board is responsible for determining the suitability of applicants to be registered as tax agents, dealing with complaints about tax agents and ensuring that proper standards are maintained across the tax agent profession.

There are stringent rules regarding registration, requiring a mix of academic qualifications and actual hands-on experience in the workplace. A higher academic qualification results in a shorter work experience requirement however, all criteria include a course of study in Australian income tax law acceptable to the Board.

An application fee applies for all new and continuing registrations. Registration lasts for three years whereupon agents need to re-register with a requirement to show the board they have

maintained the same level of relevant employment experience as needed to obtain the original registration.

Tax agents can register as an individual, partnership or company.

NEW LEGISLATIVE FRAMEWORK

In 2006 the Australian Government re-announced its intention to implement a new national legislative framework for tax practitioners. In 2006–07 we intend to collaborate with other government organisations and tax practitioners' representative bodies to design the administrative approaches that will support the new framework.

The new regime will replace the current regulatory system, first introduced in 1943. The intent of the proposed new framework is to develop a regulatory framework that ensures high quality and accessible tax agent services to the community. The new framework seeks to recognise all taxation intermediaries representing taxpayers and the design and implementation of an administrative system that supports a consistent service for the registration of tax agents and robust mechanisms to ensure the regulation of tax agents.

A National Tax Practitioners' Board is proposed. It will be responsible for regulating the provision of tax agent services and BAS services in Australia.

The deliberations of the Board will be completely independent and the Commissioner of Taxation will have no control over the proceedings of the Board.

Subject to the details of the new framework, there may be increasing scope for the Tax Office to work with the relevant professional bodies to ensure 'capable and well regulated' intermediaries.

TAX OFFICE STRATEGY

Working with tax agents

There are a wide variety of players in the revenue system that provide services and/or advice to the community, including superannuation advisors, lawyers, bookkeepers and financial planners.

From our perspective, supporting and influencing one tax practitioner means we can support and influence many taxpayers. Consultation, education, understanding the tax agent market and providing differentiated treatments to the tax agent community are hallmarks of our approach and relationship. We look for ways to make the tax practitioners experience easier, cheaper and more personalised.

We support tax practitioners to help them perform their roles by providing:

- a range of communication and support options
- advice and education services, and
- electronic tools to transact with us.

We consult with tax agents directly and through their professional bodies on administrative processes, and try to ensure that products and services are co-designed with participants in the industry.

Consultation and co-design is an important aspect of our commitment to improve our provision of technical advice to tax practitioners. Through the Australian Taxation Office Tax Practitioner Forum (ATPF) Advice Working Group and specific consultations with tax agents we are co-designing a framework that will enable practitioners to:

- be more self reliant so they can obtain the answers to non-complex issues within their practices, and
- enable the resolution of more complex issues via a seamless escalation process that respects their needs.

We also cooperate with tax practitioners and their representatives to achieve common goals such as:

- securing stronger industry support for the scrutiny of tax agents who operate outside acceptable industry norms, and
- improving the quality of bookkeeping services and the integration of bookkeepers with the wider tax profession.

Having a clear and established relationship with tax agents has assisted us with:

- identifying trends within their industry
- developing effective education strategies
- developing their industry capability, and
- influencing positive taxpayer compliance behaviour.

Our relationship with both tax agents and the wider taxpayer community allows us to take a lead in compliance management by allowing us to find the right balance between compliance activities (for example, audits, risk reviews and prosecutions) and compliance assistance (for example, education and advice).

Working with tax agents gives us an opportunity to more accurately identify compliance risks among their clients. We are committed to a transparent approach in addressing these risks.

Our goal is to work with tax professionals to continue to develop a mutually productive relationship which instils community confidence in our tax system.

Identifying agents that are non-compliant

Although most tax practitioners fully comply with tax obligations, non-compliance occurs where:

- tax practitioners fail to meet their personal lodgment or payment obligations
- tax practitioners do not keep up to date with developments in taxation
- tax practitioners promote or participate in aggressive tax planning arrangements
- tax practitioners engage in deliberate evasion or fraudulent activities, or
- unauthorised people represent themselves as tax practitioners and illegally charge fees to provide tax-related services, such as preparing tax returns for other taxpayers.

Both the community and the Tax Office expect professionals in the tax industry to lead by example and exhibit high standards of compliance with their personal lodgment obligations. In order to support the majority of practitioners who regularly meet their own lodgment obligations we continue to focus on those who do not comply.

We monitor personal lodgment compliance trends across tax agents and other tax professionals, including members of the legal profession. Our analysis of lodgment patterns identified that 4.2% of tax agents had outstanding 2004 tax returns at 31 March 2006. We have now reduced that to 1.5% of agents who have not lodged their 2004 returns at 30 June 2006.

As a result of our targeted compliance activities, in 2005-06 we finalised 2,433 income tax returns and 1,846 activity statements that were previously outstanding. In addition we successfully prosecuted 75 cases for failing to meet lodgment obligations.

The Tax Office applies a risk based approach to tax agent compliance activities. A wide range of information is used to profile tax agents and identify those with clients who are operating outside 'normal' compliance practice and who are at risk of not complying. Ensuring that agents are complying with the law and are professional in their approach is a cost effective way to minimise risk to revenue and increase community confidence in the system.

Tax agent profiles provide a snapshot of the claim behaviour of an agent's individual client base. The profile describes the tax agent, the agent's performance measures and where these performance measures place the agent in relation to other agents with similar practices (their reference group). Agents are rated based on how much they differ from their reference group norm, which allows practices falling outside the norm to be easily identified.

The data used to attribute risk to tax agents is indicative and not definitive. An ongoing task is the review of indicators and data collection to provide the best possible indicators of risk as a tool to better target compliance activity.

When we identify a tax agent who meets our risk criteria, we contact them to see whether their tax practices are contributing to their clients' risk levels. Where necessary, we help agents address poor business practices.

Where agents do not comply, and fail to deal with compliance problems that we have brought to their attention, we may need to take firmer action. This can range from audit through to

referral for prosecution and/or to the relevant Tax Agents' Board for review. We may also withdraw certain kinds of support and apply administrative sanctions - for example, denying access to lodgment deferrals and the lodgment program. We are currently looking at the feasibility of developing 'joint approaches' with professional bodies to improving the standards of particular tax agents.

Leveraged compliance approaches using intermediaries are necessary due to the scale and fundamental nature of compliance in the various segments. For example, the micro segment contains approximately 2.3 million businesses. An integral part of our compliance program is an approach that involves different levels of differentiated compliance activity aimed at assisting agents and their clients to move to a lower compliance model level through a mix of enforcement, education and products.

We are continuing to:

- collaborate with tax practitioners, their professional bodies and the Tax Agents' Boards to ensure high standards of tax practitioner integrity in the interests of taxpayers
- improve our processes to identify and respond to tax agents who operate outside acceptable industry norms.
- analyse tax agent practices to identify compliance behaviour
- use profiling and community information to identify compliance risks and deter fraud and evasion before it occurs
- monitor tax agents' compliance with the lodgment program
- refer for prosecution those who charge fees for tax-related services but are not authorised to do so. We expect to investigate more than 100 people who may be operating illegally as tax agents this year, and
- take firm action where tax practitioners choose to engage in or support activities relating to tax evasion or fraudulent and criminal activity.

A small minority of tax agents abuse their position of trust and engage in deliberate evasion or fraudulent activities. We refer such agents to the relevant Tax Agents' Board to review their registration and, where criminal activities are involved, we refer them to law enforcement agencies. In 2005-06 the Tax Agents' Boards cancelled 127 tax agent registrations and suspended a further 13 registered tax agents.

Current issues within the tax agent industry

An area of concern to both the tax profession and the Tax Office are those tax agents and unregistered operators who engage in activities that undermine the integrity of the tax system. There is general acknowledgement of the need to deal firmly with such operators.

Last year we investigated 157 unregistered tax agent cases. 10 of these cases were successfully prosecuted and there are further prosecutions pending.

An important strategic issue for tax practitioners is the future sustainability of the profession. The factors affecting sustainability are largely not unique to tax professionals and include:

- the aging demographic within the profession and the community
- difficulty attracting and retaining young professionals, given a potential skills shortage, and
- national and international trends in accounting and corporate governance.

These matters have been the subject of regular meetings which the Commissioner has with the Chief Executive Officers of the accounting bodies. Minutes of these meetings are accessible to the public via the Tax Office website www.ato.gov.au.

A growing area of attention for us and the profession is the growth of new players in the accounting service industry, such as bookkeepers who charge fees to prepare business activity statements. This is another matter discussed with the CEOs of the accounting bodies. The general consensus is that bookkeeping needs to be integrated as a subset of the broader profession. Accordingly, we are working with the tax profession including bookkeepers to design a framework for bookkeepers which recognises their complementary role with accountants and tax agents.

The 'State of the Industry' research we conducted jointly with the professional associations in 2005 showed that:

- The perception of excessive workload has reduced since it was identified in 2003 as a key problem for the industry in the coming years, with those tax agents reporting they work 'very excessive' hours declining from 28% in 2003 to 17% in 2005.
- Tax agents feel that the most critical issue for the future of the profession is the complexity of, and continual changes to the tax legislation. The other critical issues for the tax profession include the following:
 - professional indemnity costs
 - attraction and retention of quality staff
 - overall marketing of the profession
 - compliance burden
 - penalty regime, and
 - greater understanding/acknowledgment of pressures on tax agents by the Tax Office.

TAXPAYER/AGENT RELATIONSHIP

Liability of tax agents

Currently a taxpayer may be liable for tax shortfall penalties if their tax agent has provided incorrect advice or over claimed an item and this has resulted in a tax shortfall, and the agent has not exercised reasonable care or for large shortfalls did not have a reasonably arguable position. The taxpayer in this situation has the option of suing the tax agent for the amount of the shortfall penalty via section 251M of the *Income Tax Assessment Act 1936*. It is not known to what extent this section is used by taxpayers, who might also have a common law action in negligence. Attachment 9 is an extract from the Master Tax Guide and provides additional information on the liability of tax agents.

Advice on preparing returns

The Tax Office provides the following advice to tax agents on preparing a taxpayers' returns. This is available from the Tax Office website at www.ato.gov.au.

What questions do I have to ask my client when I prepare their tax return?

You need to ask reasonable and direct questions to get the information necessary for you to ascertain the correct income position and what deduction and tax offset claims can legitimately be made. In relation to deductions, you should ask the client whether the expenditure has been incurred and sufficient further questions to determine whether the expenditure is allowable as a tax deduction. Where the substantiation rules apply, you should also ask what evidence does the client have available that is necessary (for example, receipts) to support the deduction being made.

Do I have to sight the relevant receipts and records?

It is not essential to sight the receipts and records but, if they are available, they should be examined as part of the tax return preparation process. It is good professional practice to request from a client all relevant documentation relating to their claims, noting both what you have seen and what evidence the client advises you he has, but not produced to you.

When preparing a tax return for a client, do I have to conduct a 'tax audit' to ensure that the tax return is correct?

No - when preparing tax returns, tax agents are expected to adopt reasonable professional care. You should ask sufficient questions to obtain the relevant information necessary to prepare the tax return. However, tax agents have to rely on the accuracy of the information provided to them by their clients.

What if a client will not produce the records but maintains that the expenditure has been incurred and the records exist?

If you have good reason to believe that the client is seeking to make a false claim or omitting income, you should carefully consider whether or not to continue to be associated with the preparation of that tax return. If, on the other hand, you have reasonably ascertained what records the client has to support the claims being made, and you have no good reason to doubt the accuracy of the information provided, you may rely on that information when preparing the tax return. In relation to deduction items, you should carefully advise the client of the relevant substantiation rules or other requirements to support the claim and point out the significance of the declaration they have to sign on the tax return.

Can I include in a tax return a claim that is clearly not allowable?

No - the government policy embodied in the legislation is quite clear. Paragraph 251K(2)(a) of the *Income Tax Assessment Act 1936* provides that a Tax Agents' Board may cancel an agent's registration where they knowingly include on a tax return an item that is false in any material

particular. Further guidance has been given by Hill J in the Federal Court in *Stasos v. Tax Agents' Board of New South Wales* 90 ATC 4950; (1990) 21 ATR 974 where he said in 90 ATC 4950 at p. 4959 and in 21 ATR 974 at p. 984:

In addition to the tax agent dealing with his clients, he will, almost invariably have dealings with officers of the Australian Taxation Office and perhaps the boards and tribunals to which I have already referred. Those dealings must be able to be carried on in an atmosphere of mutual trust. The Commissioner and his officers must be able to accept that, to the best of the ability of the tax agent, returns that have been prepared are true and accurate. This is particularly so now that the Commissioner has proceeded to a system of self assessment, with inaccuracies only coming to light in the case of random audit or, presumably, other information coming to the hands of the Commissioner.

This means that a tax agent cannot include on a tax return a claim where they know that the relevant expenditure has not been incurred or is not allowable. Also, for example, a tax agent cannot include a claim for total work-related expenses, other than car, meal allowance, award transport payments allowance and travel allowance expenses, that exceeds \$300 if they have not reasonably ascertained that the client has kept evidence to prove the total amount.

What should I do if a client instructs me to include a false claim on a tax return?

You should advise the client of their responsibility to lodge a correct tax return and of the consequences should a false tax return be lodged and subsequently audited. You should also explain your responsibility as a professional registered tax agent. You should try to persuade the client to exclude any false claim, and if they subsequently insist on lodging a false tax return, you or your staff should have nothing further to do with the preparation of that tax return.

CHAPTER 10: MANAGED INVESTMENT SCHEMES

TAX OFFICE ADMINISTRATION OF CURRENT ARRANGEMENTS FOR PLANTATION FORESTRY AND PRIMARY PRODUCTION MANAGED INVESTMENT SCHEMES (MIS)

Product rulings were introduced in 1998 in response to the proliferation of mass marketed investment schemes to provide certainty to investors about the deductions they can claim if they participate in a Managed Investment Scheme (MIS) or similar arrangement. A product ruling is a type of public ruling that rules on the tax consequences of a particular arrangement provided the scheme is implemented as described in the ruling. Product Rulings are not issued to assist a promoter or arranger to market a project, rather they are issued solely to provide certainty for potential investors about the application of the tax laws to their investment.

When a promoter applies for a Product Ruling, full disclosure of the arrangement and accompanying documentation is required so that certainty for investors can be provided.

While applications for Product Rulings include information on the total number of allotments on offer and the minimum subscription level for each project, the Tax Office cannot identify the number of investors involved in projects because we do not know how many allotments are actually subscribed nor the number of investors who subscribe for multiple allotments.

The process of applying for a Product Ruling is also a voluntary one. There is, therefore, potential for promoters to offer interests in MIS projects and investors to participate in such arrangements without a ruling being obtained.

Taxation Ruling TR 2000/8 sets out the Tax Office view on the availability of deductions for expenditure on initial lease and management fees incurred by investors entering into afforestation schemes. The views expressed in the ruling are relevant to issues found in other investment schemes, typically including a wide range of primary production schemes such as agricultural, horticultural, tea tree oil, viticulture and livestock schemes. However, MIS where the rights under the lease and/or management agreements are 'scheme property' are outside the scope of the ruling.

TR 2000/8 provides that where there is a business of afforestation and that business is carried on by the investor, expenditure on lease and management fees that are not uncommercial is on revenue account and deductible (para. 34). This is contrasted to the situation where, for example, an investor makes an investment in the business carried on by another person, in which case the expenditure would be of a capital nature and not deductible under section 8-1.

PRODUCT RULINGS BY INDUSTRY

Table 1 below provide details of the number of Product Rulings issued by the Tax Office in the financial years 2003-04, 2004-05 and 2005-06. The number of Product Rulings issued for afforestation projects has steadily increased in this period. This increase is due largely to a

change in Tax Office practice to issue a ruling for investments offered each year rather than one ruling covering several years. Agribusiness in 2004-05 showed an 85% increase from 2003-04. This increase is partly due to the change in the Tax Office issuing multiple rulings for the same project and partly due to an increase in agribusiness projects. Film product rulings are steady.

Table 1: Product Rulings issued by industry⁹

Income Year	Product Rulings issued to 30 June	Product Ruling applications received to 30 June
2005-06		
Afforestation	51	59
Agribusiness	64	91
Films	9	24
Finance Products	10	8
Total	134	182
2004-05		
Afforestation	45	50
Agribusiness	63	72
Films	7	8
Finance Products	23	25
Total	138	155
2003-04		
Afforestation	42	29
Agribusiness	34	50
Films	6	16
Finance Products	30	29
Total	112	124

⁹ The total number of Product Rulings issued for 2003-04 and 2004-05 include 19 and 9 Product Rulings respectively that deal only with the application of the non commercial loss provisions. There is an increase in the number of rulings after 2003-04 as we started to issue separate rulings for different classes of entity.

AGRICULTURAL INDUSTRY PRODUCT RULINGS

Table 2 below shows the break-up of Product Rulings issued in the agricultural industry.

Table 2: Agricultural break-up of Product Rulings issued

Income Year	2003-04	2004-05	2005-06
Olives	5	9	8
Almond	3	8	8
Macadamia			2
Walnut			2
Orange/Citrus	1	4	2
Apricots			1
Mango		2	2
Avocado			2
Cherry			1
Abalone	1	1	2
Pearls		1	2
Cattle	1	4	4
Tomatoes			1
Grain		3	2
Truffles	1	3	1
Coffee	1	2	
Ginkgo	1		
Ginseng	1		
Viticulture	14	19	15
Wine Production	3	3	5
<i>Combined produce projects which may have multiple sites</i>			
Apple/Pear/Peach/Nectarine/Apricots/Plums		3	3
Mango/Stone Fruit/Grapefruit			1
Mango/Grapefruit	2	1	
Total	34	63	64

CHAPTER 11: FAMILY TAX BENEFITS

CLAIMING OF BENEFITS THROUGH THE TAX SYSTEM

Family Tax Benefit (FTB)

The following table shows the proportion of claimants who claim through the tax system rather than direct payment from Centrelink.

Year of Income	Proportion claiming through the tax system *
2000-2001	4.8%
2001-2002	4.7%
2002-2003	5.4%
2003-2004	6.0%

This figure represents claims made and paid through the tax system and has been extracted from the respective Family and Community Services Annual Reports for 2001/2002 through to 2004/2005. Some claims may be made through the tax system but are not eventually paid through the tax system.

Examples of such are:

- an FTB lump sum claim lodged after the tax return has issued
- claims where there is no entitlement, e.g. family income too high, or claimant already in receipt of fortnightly payments, and
- claims that cannot be processed within the processing timeframe (approximately 3 days).

In such situations, where there is an entitlement, claims will be paid by Centrelink.

There is no data available on the number of people who reduce their PAYG withholding to reflect their entitlement to FTB.

The following tables show the number and percentage of recipients claiming through the tax system, split into taxable income ranges and population sub-segment. The data is for income year 2003-04, to October 2005.

Sub-segment counts

Taxable Income Range	Business					Non-		Total*
	Income	Employees	Families	Investors	Seniors	Youth	Residents	
Less than \$0	582	697	2,269	1,720	85	12	11	2,390
Equal to \$0	115	60	962	138	22	29	1	1,011
\$1 - \$6,000	960	4,184	7,163	4,073	127	97	8	7,437
\$6,001 - \$20,000	2,468	15,972	18,807	9,656	519	284	3	19,993
\$20,001 - \$50,000	4,668	47,107	45,977	25,468	1,690	390	10	53,431
\$50,001 - \$60,000	945	11,348	9,120	6,085	506	17	2	11,996
> \$60,000	1,866	24,005	19,873	14,740	974	33	3	24,834
Totals	11,604	103,373	104,171	61,880	3,923	862	38	121,092

Percentages of sub-segments

Taxable Income Range	Business					Non-		Total*
	Income	Employees	Families	Investors	Seniors	Youth	Residents	
Less than \$0	5.02	0.67	2.18	2.78	2.17	1.39	28.95	1.97
Equal to \$0	0.99	0.06	0.92	0.22	0.56	3.36	2.63	0.83
\$1 - \$6,000	8.27	4.05	6.88	6.58	3.24	11.25	21.05	6.14
\$6,001 - \$20,000	21.27	15.45	18.05	15.60	13.23	32.95	7.89	16.51
\$20,001 - \$50,000	40.23	45.57	44.14	41.16	43.08	45.24	26.32	44.12
\$50,001 - \$60,000	8.14	10.98	8.75	9.83	12.90	1.97	5.26	9.91
> \$60,000	16.08	23.22	19.08	23.82	24.83	3.83	7.89	20.51

*Sub-segments are not mutually exclusive, and do not sum to overall total.

Note: A non-resident for income tax purposes may be a resident for family assistance purposes, and may therefore be entitled to claim FTB.

Private Health Insurance Rebate (PHIR)

The following table shows the proportion of people claiming the 30% rebate through the tax system.

Year of income	Proportion claiming through the tax system *
2001-2002	11.4%
2002-2003	8.4%
2003-2004	7.4%
2004-2005	6.6%

* The figures have been prepared from data in the respective Department of Health and Aging Annual Reports for 2001/2002 through to 2004/2005.

The following table shows the number and percentage of recipients claiming through the tax system, split into taxable income ranges and population sub-segments. The data is for income year 2003-04, to October 2005.

Sub-segment counts

Taxable Income Range	Business						Non-	Total*
	Income	Employees	Families	Investors	Seniors	Youth	Residents	
Less than \$0	481	461	1,013	1,109	540	31	66	1,568
Equal to \$0	61	46	255	108	109	39	37	417
\$1 - \$6,000	568	2,642	2,897	2,366	1,365	638	80	4,912
\$6,001 - \$20,000	2,917	16,253	14,481	12,229	9,090	2,946	64	25,225
\$20,001 - \$50,000	7,956	101,585	65,598	61,903	34,283	7,658	56	118,755
\$50,001 - \$60,000	2,314	44,547	29,280	27,400	10,351	548	6	47,017
> \$60,000	7,607	105,167	76,823	76,530	25,305	494	35	111,421
Totals	21,904	270,701	190,347	181,645	81,043	12,354	344	309,315

Percentages of sub-segments

Taxable Income Range	Business						Non-	Total*
	Income	Employees	Families	Investors	Seniors	Youth	Residents	
Less than \$0	2.20	0.17	0.53	0.61	0.67	0.25	19.19	0.51
Equal to \$0	0.28	0.02	0.13	0.06	0.13	0.32	10.76	0.13
\$1 - \$6,000	2.59	0.98	1.52	1.30	1.68	5.16	23.26	1.59
\$6,001 - \$20,000	13.32	6.00	7.61	6.73	11.22	23.85	18.60	8.16
\$20,001 - \$50,000	36.32	37.53	34.46	34.08	42.30	61.99	16.28	38.39
\$50,001 - \$60,000	10.56	16.46	15.38	15.08	12.77	4.44	1.74	15.20
> \$60,000	34.73	38.85	40.36	42.13	31.22	4.00	10.17	36.02

*Sub-segments are not mutually exclusive, and do not sum to overall total.

Note: Generally foreign residents are not eligible for the Private Health Insurance Tax Offset. However foreign residents who are classed as Australian residents for the purposes of the Health Insurance Act will be eligible. This includes visitors from countries with which Australia has made reciprocal health care agreements.

CHAPTER 12: TAX HELP

INTRODUCTION

Tax Help is currently in its 18th year of operation following the delivery of a pilot program conducted in Newcastle in 1988. The concept of Tax Help originated from a longer term program conducted by the Canada Revenue Agency.

The intent of the Tax Help Program can be articulated as:

“To assist and educate low income and disadvantaged clients to comply with their tax obligations through a community based program, and by doing so to contribute to community confidence in the tax system”

Disadvantaged clients may be identified as such due to their income, age, location, language barriers, cultural diversity or disability.

Tax Help aims to provide free assistance to low income earners to comply with their tax obligations. It is delivered through a network of volunteers operating out of a variety of centres throughout the community (such as Neighbourhood Centres, libraries, multicultural centres, Member of Parliament offices) during tax time¹⁰. Volunteers are fully trained, supported and accredited by the Tax Office to assist low income tax payers while educating them to complete their own affairs in the future. Taxpayers who meet the eligibility criteria as a low income earner can contact the Tax Office and be referred to their nearest centre to make an appointment.

Tax Help has a particular focus on working with indigenous, non-English speaking background and regional communities to develop Tax Help centres and recruit and train volunteers from within their community. Volunteers are also able to inform their communities about new initiatives (such as the Child Care Tax Rebate) and assist with claims within their communities.

In 2006, Tax Help is being delivered by 1,500 volunteers operating out of 950 different community centres nationally. The Tax Office expects to assist approximately 75,000 taxpayers.

ELIGIBILITY

Low income taxpayers are defined as earning less than \$35,000 per annum (plus an additional \$2,500 for each dependent child).

This income must be derived from non business income (such as salary and wages, Centrelink payments, Community Development Employment Program payments, interest and dividends).

¹⁰ The Tax Office advertises Tax Time as the period where individuals that do not use a tax agent need to lodge their own tax returns, generally 1 July to 31 October for any given year.

The program is not designed for taxpayers deriving business income, capital gains, complex investment income or rent.

Tax Office research has determined that a large majority of taxpayers on a low income meet the established criteria.

Eligibility is determined when taxpayers contact the Tax Office or seek an appointment with their nearest Tax Help centre. The eligibility criteria are also available on the Tax Office website.

RECRUITMENT OF VOLUNTEERS

Recruitment of volunteers is largely conducted by Tax Help centres who recruit from interested members within their community. Volunteers need not possess any accounting experience, just a willingness to provide voluntary services to other members of the community. The Tax Office assists centres with volunteer recruitment where required.

The Tax Office screens each new volunteer by conducting a discussion around expectations of all stakeholders in delivering the program, the individual's reasons for wanting be a volunteer, their hours of availability and any special language skills. This process is employed to ensure that volunteers are suited to the program and will be able to offer the service to the community during tax time, given the resources invested by the Tax Office to train them as an accredited Tax Help volunteer.

In some cases the relevant Tax Help centre may require additional screening such as a police clearance as a requirement of anyone who volunteers at their venue, however this is not a Tax Office requirement.

Each year, over 70% of volunteers return to the program. New recruitment is undertaken where necessary and generally it has been relatively easy to recruit new volunteers.

INFORMATION REGARDING TAX HELP TAXPAYERS

The following information is based on returns lodged for the 2004/05 financial year.

Gender	Percentage of Total Tax Help Taxpayers
Male	42
Female	58

Age Ranges	Percentage of Total Tax Help Taxpayers
Unspecified	Insignificant
1 to 15	1
16 to 25	20
26 to 35	12
36 to 45	16
46 to 55	13
56 to 65	15
66 to 75	13
75+	9

- The largest single age group is 16-25 year olds at 20%
- Over 55s represent 37% of clients

Income range (\$)	Percentage of Total Tax Help Taxpayers
0 to 5,000	13
5,001 to 10,000	15
10,001 to 20,000	46
20,001 to 30,000	19
30,001 to 40,000	5
40,001 to 50,000	1
50,001+	insignificant

- Largest single income range is \$10,001 to \$20,000 at 46%
- Overall 93% of clients had a taxable income under \$30,000

Income Source	Percentage of Total Tax Help Taxpayers
Centrelink + Salary & Wages	25
Centrelink + Other (excluding Salary & Wages)	21
Salary & Wage income only	15
S&W + Other (excluding Centrelink)	9
Centrelink Income only	6

TAX OFFICE FUNDING FOR THE PROGRAM

The Tax Office funding for the program consists of a number of components:

- Staff are employed to provide training and ongoing support to volunteers and centres, develop training and reference material and to administer payment of reimbursements. Approximately 26 full time equivalent staff are devoted to the Tax Help program nationally.
- Other expenses are incurred to provide printed training material, purchase consumables and fund staff travel to conduct training and support activities. The Tax Office also acknowledges volunteers with a certificate of appreciation and a small gift at end of season ceremonies each year.
- The Tax Office reimburses volunteers and centres for out of pocket expenses associated with the program, such as travel to training or appointments, consumables such as paper and printer supplies.

The following figures are based on budgeted expenditure for the 2006/07 financial year.

Staff salary costs (including direct salary and all on costs)	\$1,676,158
Other expenses	\$ 177,120
Reimbursements to volunteers and centres	<u>\$ 225,000</u>
Total planned expenditure	<u>\$2,078,278</u>

CHAPTER 13: FBT AND CHILDCARE

PUBLIC DOCUMENT RELEVANT TO THIS CHAPTER

The following document is available from the Tax Office website www.ato.gov.au and is relevant to the provision of childcare and fringe benefits tax:

- Taxation Ruling 2000/4 – Fringe benefits tax: meaning of ‘business premises’

GENERAL INFORMATION

The *Fringe Benefits Tax Assessment Act 1986* (FBTAA) was enacted and came into force as from the 24 June 1986 when it received Royal Assent. The Fringe Benefits Tax (FBT) assessment period covers from 1 April of one year to 31 March of the next year. Childcare as a fringe benefit can be provided by an employer to an employee in two ways with very different FBT consequences.

Recreational and childcare facilities are exempt benefits under sub-section 47(2) of the FBTAA if the facilities are provided by an employer on the employer’s “business premise” for the benefit of the employees. This benefit may or may not be provided to an employee through a salary sacrifice arrangement (SSA). The costs of providing this childcare in the employer’s business premise are borne by the employer (even though these costs may be recovered by way of the SSA with the relevant employee). The employee in this situation has technically incurred no childcare expenses.

In a situation where an employee places his or her child in a childcare centre and would normally have to personally pay for that service from post-taxed income and if under SSA, the employer pays for it on behalf of the employee or reimburses the employee for the amount that has already been paid, this is a taxable expense payment fringe benefit under section 20 of the FBTAA and the employer has a FBT liability. This is not an exempt recreational or childcare facility benefit as described above.

Regardless of whether the arrangement is provided under an SSA or not, an employee receiving an exempt childcare facility benefit under section 47(2) of the FBTAA will not be entitled to a childcare benefit/childcare tax rebate (CCB/CCTR) whereas an employee receiving an FBT taxable expense payment child care benefit under section 20 of the FBTAA may be entitled to a CCB/CCTR.

The law does not treat Commonwealth Department/Agency employees any differently from any other employees when it comes to the administration of the FBT legislation or the determination of CCB/CCTR entitlement.

MEANING OF BUSINESS PREMISES

Taxation Ruling 2000/4 considers what constitutes 'business premises' for the purposes of the *Fringe Benefits Tax Assessment Act 1986*. This ruling was issued on 1 March 2000 and finalised draft taxation ruling TR 1999/D11 released in August 1999.

Prior to this the Tax Office view on the meaning of 'business premises' was contained in Taxation Ruling TR 96/27.

TAX OFFICE PROVISION OF CHILDCARE

Tax Office employees, engaged under the various AWAs and Certified Agency Agreements, are entitled to enter into salary packaging arrangements in relation to exempt child care benefits. This enables employees to enter into such salary packaging arrangements where the child care is provided on the business premises of the Tax Office, or another authority of the Commonwealth.

Childcare at Belconnen office

In April 2006, the Tax Office terminated its membership of a Commonwealth management consortium with the Australian Bureau of Statistics for the direct provision of child care to Tax Office employees at Bluebell Early Childhood Education Centre ('Bluebell') at Belconnen in the Australian Capital Territory. This was the last arrangement for the provision of child care that the Tax Office had in place.

To avoid disruption to their personal child care arrangements, the Australian Bureau of Statistics and the Tax Office have agreed to transitional arrangements that enable the children of those Tax Office employees who currently attend Bluebell to maintain their places at the Centre (under the conditions of a new agreement between the Centre and the Australian Bureau of Statistics) until they find alternative care arrangements or they leave to attend school. Upon leaving, those places will transfer to the children of employees of the Australian Bureau of Statistics.

Prior to April 2006, our involvement in the Commonwealth management consortium meant that Bluebell was considered the business premises of the Tax Office. Following the withdrawal from that consortium in April 2006, that premises was no longer the business premises of the Tax Office. However, the premises continued to be the business premises of the Australian Bureau of Statistics, which is an authority of the Commonwealth.

Accordingly, in future, Tax Office employees may apply to salary package exempt child care benefits at Bluebell like any other child care centre operated on the business premises of an authority of the Commonwealth.

HOUSE STANDING COMMITTEE ON FAMILY AND HUMAN SERVICES

The Commissioner wrote to the House of Representatives Standing Committee on Family and Human Services on 14 August 2006, in relation to its inquiry into balancing work and family. The letter provided answers to questions taken on notice at a public hearing of the House Committee conducted on 21 June 2006. The questions and our responses are provided below.

Which Commonwealth departments and/or agencies have taken advantage of Fringe Benefit Tax (FBT) exemptions pursuant to the ATO public taxation ruling TR 2000/4 of 1 March 2000 to enable their employees to salary sacrifice (convert part of their annual salary) for childcare expenses ('Commonwealth agencies' refers to all entities covered by one of the *Financial Management and Accountability Act 1997*, the *Commonwealth Authorities and Companies Act 1997*, or the *Parliamentary Service Act 1999*)?

Answer: Under the tax system a taxpayer may self assess a transaction to be FBT exempt in accordance with the law. There is no requirement for the taxpayer to disclose this fact in their tax return. The Commissioner is, therefore, unable to identify which Commonwealth departments and/or agencies have taken advantage of the FBT exemption which we consider is available under the FBT law in these circumstances.

Which Commonwealth departments and/or agencies have obtained, or applied for, a private ruling on salary sacrificing their employees' child care expenses?

Answer: As far as we can ascertain, three Commonwealth government departments and/or agencies have applied for private rulings in relation to salary packaging arrangement and child care benefits. However, having regard to the secrecy provisions of the tax law it would be inappropriate, unless directed, to provide further details about them.

On which dates were these applications for private rulings made and/or approved?

Answer: The two completed private rulings mentioned above were published in 5 November 2004 and 26 June 2006. A third ruling is under development.

What are the Child Care Benefit (CCB) and Child Care Tax Rebate (CCTR) eligibility implications for Commonwealth employees who are salary sacrificing their child care costs?

Answer: Recreational and child care facilities are exempt benefits under sub-section 47(2) of the *Fringe Benefits Tax Assessment Act 1986* (FBTAA) if the facilities are provided by an employer on the employer's 'business premise' for the benefit of the employees. This benefit may or may not be provided to an employee through a salary sacrifice arrangement (SSA). The costs of providing this child care in the employer's business premise are borne by the employer

(even though these costs may be recovered by way of the SSA with the relevant employee). The employee in this situation has technically incurred no child care expenses.

In a situation where an employee places his or her child in a child care centre and if under SSA, the employer pays the child care centre on behalf of the employee or reimburses the employee for the amount that has already been paid, this is a taxable expense payment fringe benefit under section 20 of the FBTAA. The employer has a fringe benefits tax (FBT) liability. This is not an exempt recreational or child care facility benefit as described above.

Regardless of whether the arrangement is provided under an SSA or not, an employee receiving an exempt child care facility benefit will not be entitled to a CCB/CCTR whereas an employee receiving an FBT taxable expense payment child care benefit may be entitled to a CCB/CCTR.

The law does not treat Commonwealth employees any differently from any other employees when it comes to determining CCB/CCTR eligibility.

Has the Australian Taxation Office either obtained, or applied for, a private ruling from the Commissioner of Taxation on salary sacrificing its employees' child care expenses?

Answer: No. The Tax Office, as an employer, after reviewing publicly available guidance issued by the tax administration arm of the Office, formed its own view in relation to the application of FBT exemption for the salary packaging of child care expense payments.

When did the Australian Taxation Office first offer salary sacrificing to its employees?

Answer: 1998

How many employees of the Australian Taxation Office, ongoing and non-ongoing, have availed themselves of each of the individual salary sacrificing categories in the 2004 Agency Agreement for General Employees (clause 67.1)?

Answer: For the month of March 2006, the following number of salary packaging arrangements were in place within the Tax Office. These arrangements relate to employees engaged under various AWAs and Certified Agency Agreements. An employee may salary package more than one item in these categories, so there may be an overstatement of the total number of employees who avail themselves of salary packaging in the figures provided below.

Cars & utility vehicles	720
Motor cycles	nil
Car parking	21
Superannuation	840
*Portable computers	223
Exempt child care	32
*Airline lounge memberships	7
*Professional association membership fees	15

*Note: The number of employees who use these benefits in any 12 month period would be significantly more than the number shown for the month of March 2006. These benefits are provided as one-off arrangements and the employees who avail themselves of these benefits in one month may not be the same employees in the next month.

How many employees of the Australian Tax Office are currently salary sacrificing their child care expenses? Are their children attending premises of the Australian Taxation Office, other Commonwealth agencies or other entities? Are these premises owned or leased?

Answer: There are currently 28 employees who currently salary package exempt child care benefits. Their children attend child care on the premises of other Commonwealth agencies. (This number represents a reduction from the number who salary sacrificed child care benefits in March 2006– see Question 7).

Before approving applications for salary packaging of exempt child care payments at a child care centre, the Tax Office satisfies itself that all the requirements of the FBT legislation are met, including those relating to the location being on the business premises of an authority of a Commonwealth authority. For the purposes of satisfying the definition of 'business premises', the applicable test is possession and control by a Commonwealth authority. The Tax Office does not specifically review the ownership or lease arrangements for each individual child care centre. There is a range of other means that may be used to satisfy this test. Consequently, we are unable to provide details as to which premises are owned and which are leased.

We understand that the Australian Taxation Office reviewed the child care arrangements for its staff. What were the aims and outcomes of this review? May we have a copy of the review report?

Answer: In May 2005, the Tax Office considered whether there was any industrial arrangements in place to continue its involvement with the two remaining child care centres for the provision of child care for employees, Bluebell Early Childhood Education Centre in the ACT and the South Coast Workers' Child Care Centre at Wollongong. As there were no such industrial arrangements in place, the Tax Office decided to withdraw from these arrangements at the first available opportunity.

The decision to withdraw from direct involvement with the two centres did not affect the provision for salary sacrificing of child care expenses for Tax Office employees contained in the Agency Agreements in place at the time. We take the view that the FBT legislation allows arrangements with other Commonwealth government agencies providing child care on their business premises.

CHAPTER 14: EMPLOYEE BENEFIT ARRANGEMENTS

Of approximately 5,750 cases where an adjustment was made for Employee Benefit Arrangement (EBA) participation, around 90% have finalised their income tax dispute with the Tax Office. There are currently only about 270 cases in formal dispute (comprising approximately 230 appeals and 40 objections).

The number of disputed cases has reduced recently as a result of discussions between the Tax Office and key advisors which has led to a large number of participants in certain employee share plans and offshore superannuation schemes settling their disputes.

PERSONAL CONTACT WITH TAXPAYERS

We have been communicating directly with participants in schemes either by phone or letter. Many respond positively to our personal contact and discussion includes their individual circumstances, possible settlement for all their arrangements, indication of their likely debt position and options for payment. Our general settlement letter provides participants with a phone number that they can call if they require further settlement information including the outstanding debt that will remain to be paid should they decide to settle. The phone number is 1800 001 111.

MULTIPLE ASSESSMENTS (FEBRUARY 2006 INITIATIVE)

The Tax Office has completed a process of amending to nil the fringe benefits tax liability in cases where there is a high degree of judicial certainty for the income tax liability (i.e. where the arrangements are on all fours with either the *Essenbourne*, *Kajewski* or *Spotlight/Pridecraft P/L* case).

Of the 400 potential cases identified and reviewed by the Tax Office, 245 fringe benefits tax assessments have been amended to nil.

REMISSIONS OF INTEREST AND/OR PENALTY AFTER THE INSPECTOR-GENERAL OF TAXATION'S REVIEW

Steps to improve the administration of the general interest charge were announced on 18 November 2004 following a review by the Inspector-General of Taxation. Letters were sent to all EBA participants and their agents informing them of remission arrangements.

Over 1,000 participants have received a partial remission of interest that capped their interest as at 19 January 2005 to 70% of the primary tax. This resulted in over \$36 million in interest being remitted.

Guidelines were issued for participants to apply for remission of interest and/or penalty and over 1600 applications have been received under these guidelines. 99% of the applications

received have been reviewed (a small number of applications still are being received) and remission has been granted in over 1,050 cases (64%). The balance did not satisfy the criteria in the guidelines for remission.

RECENT COURT DECISION – EBA AND FRINGE BENEFITS TAX

The Tax Office has been criticised for its position in wanting to test before the Full Federal Court the finding of Keifel J in *Essenbourne* (December 2002) that fringe benefits tax should not apply to an employee benefit trust arrangement. The Tax Office publicly outlined its view in March 2003 that given that the scheme was rendered ineffective by the Court's decision to deny income tax deductibility for the contributions, this case was not the best vehicle to test the FBT issue. The Tax Office stated that it would be looking to test its view on how fringe benefits tax applies to these types of arrangements in future court cases.

In the *Essenbourne* case a deduction for a contribution to an employee incentive trust was held not to be deductible for income tax purposes because the payment was simply a distribution of the company's profits to the three principals of the company. As such it was not suitable to appeal the case in relation to fringe benefits tax as the contributions could not have been paid in the context of the employment relationship.

There have since been a number of cases where the Court has found similarly against income tax deductibility for employee benefit arrangements but has followed the comments of Keifel J in *Essenbourne* in relation to fringe benefits tax (*Walstern*, *Spotlight/Pridecraft P/L* and more recently *Cameron Brae* (currently subject to appeal)). While these cases all involve questions of fact, the fringe benefits tax issue is a matter that requires clarification of the law by the Full Federal Court. As a matter of comity, an earlier decision of a single justice is followed unless the later case is either distinguishable or the decision is considered to be clearly wrong.

In the recent *Cameron Brae* case Ryan J found there were sufficient parallels with *Essenbourne* to warrant conclusion that the contribution was not deductible. The evidence pointed to the contribution being made to establish a mechanism to distribute surplus income and did not entail the provision of a benefit in respect to employment. The Court added that if it had been then the payment might not have been made to a complying fund.

The Tax Office has received advice from the Solicitor-General that the Attorney-General's Chief General Counsel stating that it may be appropriate in exceptional circumstances for the Tax Office to challenge an earlier decision which it considers to be wrong, where there is credible legal advice to that effect. The advice also states that the Tax Office should put those affected on notice of its view and that it would also normally be appropriate for the Tax Office to fund any further challenge.

We received advice from senior counsel supporting the Tax Office's view that the Court's decision in relation to fringe benefits tax in *Essenbourne* was wrong. In counsel's view the Tax Office's construction of the fringe benefits tax law as stated in Taxation Ruling TR 1999/5 is correct.

In order to obtain clarification of the law by the Full Federal Court, the Tax Office is funding the case of *Indooroopilly Childrens Services (Qld) Pty Ltd v FCT*. A single justice of the Federal Court recently handed down its decision in this matter following Keifel J's decision in *Essenbourne*. The Tax Office has now lodged an appeal which will enable the matter to be fully considered by the Full Federal Court. We expect the appeal to be heard late in 2006 or in early 2007.

CHAPTER 15: RUNNING BALANCE ACCOUNTS

BACKGROUND

Prior to 1 July 1999, the various different business taxes were administered through several different computer systems. Each system would separately account for the different periodic debts and the payments would be matched to those liabilities in accordance with payment advice forms received from taxpayers. The different business taxes attracted different penalty and different rates of interest for late payment.

Taxation Laws Amendment Act (No. 3) 1999 (effective from 1 July 1999) amended the *Taxation Administration Act 1953* (TAA) and established the system of running balance accounts (RBA) and rules for the application of payments and credits against tax debts. The amendments also abolished numerous inconsistent and punitive culpability penalty elements which applied to late payments of taxes and introduced a common single rate of interest - the general interest charge. This was in response to recommendations made by the Government's Small Business Deregulation Task Force.

Further amendments were made to the RBA provisions in 2000 to support the introduction of a range of new business tax obligations under the Government's Tax Reforms. The new business tax debts for GST, PAYG withholding and PAYG instalments were notified in the business activity statement (BAS) and recorded in a single RBA along with any associated payments and credit entitlements.

Where an RBA is established to account for particular taxes the law aggregates specific periodic or primary tax debts into a single RBA deficit debt. Payments made in respect of those liabilities are allocated to the RBA and reduce the deficit balance in that account. This enables the Commissioner to produce regular account statements showing the total of transactions on the account. The Commissioner can take recovery action against the RBA deficit as an unpaid tax related liability rather than pursue the unpaid amounts of the individual components debts.

The RBA is analogous to a credit card account. The account is used to record different liabilities, but payments are made to reduce the outstanding balance on the account and are not applied against the particular transactions that make up the account debt.

At present, all BAS amounts are administered in an RBA. Other taxation debts such as income tax, fringe benefits tax and superannuation debts are administered in non-RBA accounts on separate accounting systems.

APPLICATION OF PAYMENTS TO TAX DEBTS

To support effective administration of the taxation debts the accounting rules in the law give the Commissioner the discretion not to take into account any direction from the taxpayer. Nevertheless, the Commissioner has a principle of generally giving effect to the request of a taxpayer by directing a payment to its intended purpose.

Processing payments into a particular account is facilitated by the payment reference number (PRN) in the payment advice form or the electronic transactions code. The PRN identifies the taxpayer and the type of tax for which the payment is made. It enables the payment to be directed to the appropriate account administered by a particular accounting system.

For example, where a taxpayer makes a payment using a payment advice form attached to a particular paper BAS (or EFT code that relates to a BAS) the payment will be directed to the RBA to reduce the balance of that account. The amount is not directed to specifically reduce the component debts reported on the BAS, such as the GST debt or PAYG withholding debt. The payment is an undissected amount that is allocated as a credit transaction to the RBA. The various component debts are recorded as debit transactions on the RBA upon processing of the BAS.

Where a taxpayer makes a full payment in respect of a particular tax debt, other than a BAS payment, the payment will be allocated to that particular tax type account and be matched to the intended debt, regardless of whether there are earlier unpaid tax debts within that account. Where only part payment is made of a tax debt the amount will be allocated to that particular tax type account and, in the absence of a matching tax debt, be applied to the earliest tax debt within that account. For example, where a taxpayer makes a part payment of income tax, the payment will be applied to reduce the earliest debt within the income tax account.

Where a taxpayer uses the wrong payment advice form or EFT code and the payment is directed to the wrong account adjusting entries are made through manual processes to redirect the payment against the intended debt.

Some payments that have been credited to an account may need to be transferred where there has been an error by the taxpayer or the Commissioner. Accordingly, these payments may need to be transferred to different taxpayers' accounts (provided it is legal to do so) or across different accounts for the same taxpayer/entity (for example, from a taxpayer's income tax account to the same taxpayer's Integrated Client Account containing BAS obligations). Most of these situations arise where taxpayers request the Tax Office to correct the error and such requests (if appropriate) are followed.

Sometimes payments are received for a greater amount than the balance of the account. In the absence of further instructions from the taxpayer, this surplus credit will be allocated to the taxpayer's other outstanding accounts in the order specified in Chapter 7 of the ATO Receivables Policy (which relates to the allocation of payments and credits). The general policy that applies in relation to the allocation of excess payments is that the payment is applied against the earliest debt in the particular account.

CHAPTER 16: TOTAL REFUNDS IN 1992-93 AND 2004-05

BACKGROUND

An additional question on notice was received from the Committee by the Tax Office on 31 July 2006. The question was:

“In reference to the table headed 'Then and Now' [ATO, Submission No. 50, p. 4] why have the total number of refunds increased from 11.8 percent of total revenue collected (13.4 percent of income tax collections) in 1992-93 to 23.6 percent (32.5 percent of income tax collections in 2004-05?”

RESPONSE

The table below illustrates amounts refunded, by type of tax, in the 1992-93 and 2004-05 financial years. This information has been derived from the Commissioner of Taxation's Annual Reports from the relevant years¹¹.

Income tax refunds in 1992-93 represented approximately 11.8% of total revenue collected. Income tax refunds in 2004-05 represented approximately 10.5% of total revenue collected.

Higher total refunds in part reflect activity statement refunds which are generally GST refunds (refunds of GST paid on inputs). Activity statement refunds totalled \$28.1 billion in 2004-05, which is 13% of total revenue. Sales tax refunds on the other hand accounted for \$173 million in 1992-93, less than 1% of the total collections.

¹¹ From Annual Report 1992/93 page 139 and 2004/05 page 42.

Amount refunded, by type of tax, 1992/93 and 2004/05		
Tax, duty or charge	1992/93 \$m	2004/05 \$m
Income tax		
Total individuals	7,833 ^(a)	15,115 ^(b)
Companies	720	5,668
Superannuation funds	63	1,182 ^(c)
Withholding tax	9	na ^(d)
Resource rent tax	15	184
Fringe benefits tax	35	353 ^(e)
Total income tax	8,674	22,502
Sales tax	173	18
Other	2 ^(f)	na
Excise	na	41 ^(g)
Activity statements	na	28,104
Total	8,848	50,665

NOTE

Rounding may cause totals to differ from the sum of components.

- a Includes PAYE, Collections on Assessments and Prescribed Payments System. Furthermore, refunds of collections for Medicare Levy are also included here.
- b Includes refunds of collections for Medicare levy.
- c Includes superannuation surcharge refunds.
- d Interest, royalty and tax file number withholding tax refunds are included with activity statements and are no longer available separately.
- e Excludes Australian Government on-Budget departments and authorities.
- f Includes pay-roll tax, estate duty, gift duty, recoupment tax and miscellaneous fees and fines.
- g Excludes the impact of fuel grants.

ATTACHMENT 1: TEST CASE LITIGATION PANEL MEMBERS

CURRENT MEMBERS

Name	Position
Bruce Quigley	Chair - Deputy Chief Tax Counsel, Tax Office
Steve Martin	Deputy Chair - Senior Tax Counsel (Strategic Litigation), Tax Office
James Momsen	Barrister-at-Law. When Mr Momsen was appointed to the Panel in 1997 he was an international partner in Baker & McKenzie, Solicitors, Sydney. He has held such posts as a Governor of the Australian Tax Research Foundation and the Chairman of its Research Advisory Board as well as being a member and Chairman of the Taxation Committee, Law Council of Australia. He has lectured in the Master of Taxation course at the University of Sydney.
Peter Poulos	Solicitor. Mr Poulos is a Partner in Maddocks Lawyers in the Tax Disputes Group specialising in tax disputes with the ATO. He headed the Sydney Tax Practice of the Australian Government Solicitors Office for many years before taking up private practice.
Graeme Wade	Accountant. Mr Wade is a principal at Wade Mayall & Co Pty Ltd. When he was appointed to the Panel in 1997 he was a Fellow of the Taxation Institute of Australia, a Certified Practising Accountant and member of the Australian Taxpayers Association, and has been active on professional committees. He has been an Executive of the Victorian Public Accounts Committee.
Hon. John Clarke QC	Mr. Clarke was appointed to the Panel in 2006. He practised at the NSW Bar from 1959 and became a QC in 1976. He was a judge of the NSW Supreme Court from 1983 to 1997 and also served as a member of the Court of Appeal. Since his retirement he has sat as an Acting Judge of Appeal.

PAST EXTERNAL MEMBERS

This is a list of external Panel members who have sat at various times since the inaugural meeting on 6-7 May 1997.

Name	Position
Professor Bob Baxt	Appointed to the Panel in 1997. Professor Baxt brings a distinguished academic background, having been Professor of Law and Dean of the Faculty of Law at Monash University, and subsequently Professorial Associate at Melbourne University. For 3 years (1988-1991) he was Chairman of the Trade Practices Commission, and then joined Arthur Robinson and Hedderwicks as a tax and commercial law partner. He has written major textbooks on tax and other topics and is a past President of the Banking Law Association. He was a member of the Tax Committee of the Law Council of Australia.
Ian Langford-Brown	Chartered Accountant. Former Taxation Director of the Institute of Chartered Accountants.
John Azzi	Barrister-at-Law
Professor Yuri Grbich	Appointed to the Panel in 1997. Professor Grbich was a Professor of Law at UNSW. Prior to 1983 he was an Associate Professor at Monash. He was the founding Director of the ATAX Program at UNSW. His writings and public presentations have been in the areas of basic tax concepts, tax avoidance, trusts and taxation of trusts, tax law improvement, and institutional aspects of tax. He has been at the forefront of tax education and public discussion of policy and the tax reform debate. He has been a senior member of the Administrative Appeals Tribunal in its tax jurisdiction.
Brian Pape	At the time of his appointment in 1997 Mr Pape had been practising as a barrister in the field of taxation law for 20 years. He was a former Governor of the Australian Tax Research Foundation. From 1992 to 1994 he was a member of the Australian Accounting Standards Board. He was a member of Taxation Board of Review No 1 from 1981 to 1984. He has wide experience in taxation litigation.
Mark Brabazon	At the time of his appointment in 1997, Mr. Brabazon was a Barrister who had represented and advised in taxation matters since 1987. Among other professional memberships he was a member of a group known as Lawyers engaged in Alternative Dispute Resolution. He was a director of the Public Interest Law Clearing House Incorporated, a joint initiative of the Law Society of NSW, the Public Interest Advocacy Centre Ltd and a number of law firms. Its objects include identifying major issues of public interest needing legal assistance.

SOME FORMER TAX OFFICE MEMBERS

Name	Position
Bob Tomkins	ATO Solicitor
Michael Bersten	Deputy Chief Tax Counsel
Phil Foster	National Program Manager
Iain Anderson	ATO Solicitor
Leo Hardiman	ATO Solicitor
Amarjit Verick	Senior Tax Counsel

ATTACHMENT 2

ATTACHMENT 2: TEST CASE APPLICATIONS - FUNDED CASES (2003 - 2006)

Financial Year	Type of funding	Issue	Venue	Outcome of Court decision	Comments
03/04	Commissioner's prerogative	Assessability of lump sum redemption payments made in accordance with s137 of the SRC Act.	Federal Court	Commissioner successful	The Full Court dismissed the appeal. Taxpayer's counsel conceded that he could offer nothing by way of argument to counter Tax Office submissions, so there was not a fully reasoned decision by the court.
03/04	Panel	Jurisdiction of the AAT to hear objection from decision of Commissioner not to extend time to make an election under section 139E of the ITAA 1936	Federal Court	Commissioner successful	The Panel considered that this case would add to the body of law that explains when decisions made by the Commissioner form part of the assessment process and when they are subject to judicial review. The taxpayer appealed this decision and we agreed to fund the appeal to the Full Federal Court.
03/04	High Court	Deductibility of money stolen/ policy issue due to money being 'earmarked' for purchase of drugs	Special leave application to the High Court	Taxpayer successful	Special leave to appeal was refused by the High Court with costs. The Commissioner undertook to pay the respondent's costs for counsel and solicitors at special leave and if leave was granted, the appeal. Leave was refused. With the judicial process exhausted, Government subsequently provided legislation to overcome the situation of taxpayers receiving deductions for criminal activity (<i>Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Act 2005 (147 of 2005)</i>).
03/04	Panel	Whether Commissioner can be bound by an oral representation granting an extension of time to comply when no such provision is made specifically in the legislation for such extension	N/a	No decision	Commissioner withdrew.
03/04	High Court	Character of receipt by person engaged in sporting activity. Whether the taxpayer was carrying on a business	High Court	Commissioner successful	The case provided useful further guidance on the issues raised in Commissioner's ruling TR 1999/17, dealing with sportspersons and receipts, and other benefits.

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Financial Year	Type of funding	Issue	Venue	Outcome of Court decision	Comments
03/04	Adverse Decision	Part 2-42 of the <i>Income Tax Assessment Act 1997</i> .	Federal Court	Commissioner successful	
03/04	Commissioner's prerogative	Application of Part IVA to the Alienation of Personal Services Income (PSI)	AAT	Taxpayer successful	Following this decision, draft determination TD 2004/D82 was finalised and issued as TD 2005/29. The Commissioner also subsequently issued a statement on the "Refocus of the income splitting test case program" that, in the absence of unusual features in husband and wife partnerships such as those in <i>Ryan</i> , it would ordinarily be difficult to conclude, having regard to the s 177D factors, that the dominant purpose of the partnership arrangement is the obtaining of a tax benefit through the equal division of profits and losses.
03/04	Adverse Decision	Application of sec 35-10 precluding claim of business losses against assessable income from other sources for a given year	Federal Court	Commissioner successful	The decision supported the Commissioner's position in Taxation Ruling TR 2003/3.
03/04	Adverse Decision	Whether the Foundation is entitled to endorsement as an entity exempt from income tax.	Federal Court	Taxpayer successful	The Court found that the Foundation was entitled to endorsement as an entity exempt from income tax under s50-105, being a charitable institution under Item 1.1 of the table to s50-5. The fact that individuals may benefit from the Foundation's activities does not detract from its charitable status. The Commissioner accepted the outcome and Ruling TR 2005/21 'Charities' was changed to incorporate the learnings from the decision.
03/04	Commissioner's prerogative	Part IVA and Personal Services Income	Federal Court	No decision	Matter settled, given refocus of the income splitting test case program.

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Financial Year	Type of funding	Issue	Venue	Outcome of Court decision	Comments
03/04	Panel	Priority of Commissioner in liquidation. Interaction of s 52 <i>Superannuation Guarantee Administration Act 1992</i> and paragraphs 556(1)(a) and (e) of the <i>Corporations Act</i> .	Supreme Court	Commissioner successful	The outcome represents a higher degree of certainty provided for official receivers/liquidators/trustees in bankruptcy as to the Tax Office's priority for SGC debts in respect of company directors.
03/04	Panel	Whether acquisitions made in recovery of debt portfolio are creditable acquisitions for the purposes of sections 11-20, 11-5 and 11-15 of the GST Act	AAT	Partially Favourable to both parties	The taxpayer filed an appeal to the Full Federal Court, the Commissioner filed a notice of contention. The taxpayer was offered funding.
03/04	Commissioner's prerogative	Payment made in redemption of weekly payments of compensation payable to servicemen after discharge from Army - income, capital, Eligible Termination Payment (ETP) or invalidity payment	Federal Court	Taxpayer successful	In allowing the taxpayer's cross-appeal, the matter was remitted back to the Tribunal for some further findings.
03/04	Panel	Definition of 'residential premises' in GST Act. (Sections 195-1; 40-30; 40-65)	AAT	No decision	The taxpayer did not ultimately proceed with litigation of this issue
04/05	Panel	Whether the taxpayer passes the results test for the purposes of section 87-18 of the Income Tax Assessment Act 1997 for the years ended 30 June 2002 and 2003?	Federal Court	Matter not yet progressed to hearing	

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Financial Year	Type of funding	Issue	Venue	Outcome of Court decision	Comments
04/05	Panel	Whether the Commissioner's formal information gathering power (s 264) may override implied undertakings given to a Court by parties to legal proceedings.	NSW Court of Appeal	Commissioner successful	The Court exercised its discretion and released the taxpayers from their implied undertaking to the Court without the need to determine the precise scope of s264.
04/05	Panel	Whether acquisitions made in recovery of debt portfolio are creditable acquisitions for the purposes of sections 11-20, 11-5 and 11-15 of the GST Act	Full Federal Court	Commissioner successful	The decision confirms the Tax Office view.
04/05	Panel	Whether a hotel suite purchased under a particular hotel scheme has a 'creditable purpose' as defined by section 11-5 of the GST Act and whether the ATO interpretation, as expressed in GSTR 2000/20, is correct	N/A	N/A	The taxpayer did not ultimately proceed with litigation of this issue.
04/05	Commissioner's prerogative	Whether lodgment of a nil income tax company return under the self-assessment regime of the <i>ITAA 1936</i> was a deemed assessment	Full Federal Court	Commissioner successful	The decision affirms the Tax Office view in TD 2004/24. Exposure Draft Taxation Laws Amendment (Improvements to Self Assessment) Bill No 2 2005 proposes that from the 2004-05 income tax year, where a taxpayer lodges a nil or loss return, the Tax Office will only have a limited period within which to review the return, which will run from the date the return is lodged.
04/05	Panel	Part IVA	Federal Court	Matter not yet progressed to hearing	
04/05	Panel	Whether insurance proceeds from superannuation are concessionally treated by either s.27A(1)(n) or s.27G	N/A	Matter not yet progressed to court	Still at objection stage.

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Financial Year	Type of funding	Issue	Venue	Outcome of Court decision	Comments
04/05	Panel	Tax deductibility of player management fees and other costs incurred by professional sportspersons	N/A	Matter not yet progressed to hearing	
04/05	Panel	Relationship between the purchase of land and the hotel that sits on the land individually and how GST is to be applied	AAT	Matter not yet progressed to hearing	
04/05	Panel	what amounts should be included in calculating the 10% rule provided in s.82AAS of the ITAA 1936	AAT	No decision	Commissioner withdrew, accepting the taxpayer's position, and ATO precedents changed appropriately.
04/05	Commissioner's prerogative	Alienation of Personal Services Income (PSI)	N/A	N/A	Case finalised before the matter progressed to court following the Commissioner's concession on Part IVA.
04/05	Commissioner's prerogative	Alienation of PSI	N/A	Matter not yet progressed to court	
04/05	Commissioner's prerogative	Alienation of PSI	N/A	N/A	Case finalised before the matter progressed to court following the Commissioner's concession on Part IVA.
04/05	Commissioner's prerogative	Alienation of PSI	N/A	N/A	Case finalised before the matter progressed to court following the Commissioner's concession on Part IVA.

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Financial Year	Type of funding	Issue	Venue	Outcome of Court decision	Comments
04/05	Commissioner's prerogative	Alienation of PSI	N/A	N/A	Case finalised before the matter progressed to court following the Commissioner's concession on Part IVA.
04/05	Commissioner's prerogative	Alienation of PSI	AAT	Matter not yet progressed to hearing	
04/05	Commissioner's prerogative	Alienation of PSI	AAT	N/A	Case was dismissed by the AAT - they could not contact the taxpayer.
04/05	Commissioner's prerogative	Alienation of PSI	N/A	N/A	Case finalised before the matter progressed to court following the Commissioner's concession on Part IVA.
04/05	Commissioner's prerogative	Alienation of PSI	N/A	N/A	Case finalised before the matter progressed to court following the Commissioner's concession on Part IVA.
04/05	High Court	Whether a company in liquidation can carry forward losses into later years of income.	High Court	Commissioner successful	Following the decision, the Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Bill 2005, was introduced into Parliament on 14 September 2005. For companies carrying forward losses, it modified the continuity of ownership test (by providing tracing rules) and removed the same business test for companies (including consolidated groups) with "total income" less than \$100m in an income year.

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Financial Year	Type of funding	Issue	Venue	Outcome of Court decision	Comments
05/06	Panel	Whether the AAT in reviewing the objection decision could exercise the Commissioner's power to allow further time to the taxpayer to make an election under section 139E of the ITAA1936.	Full Federal Court	Commissioner successful	The decision affirms the Tax Office position to refuse an extension of time, except in exceptional circumstances (as reflected in ATO IDs).
05/06	Panel	Whether the AAT has jurisdiction to review the Commissioner's decision under section 16-45 of schedule 1 of TAA not to remit penalty imposed on the taxpayer for failing to make and remit to the Commissioner PAYG withholding amounts.	Federal Court	Matter not yet progressed to court	In principle funding was offered to the taxpayer subject to the AAT stating the case to the Federal Court on the jurisdiction issue. This has not yet happened.
05/06	Panel	Whether the <i>Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Assessment and Collection Act 1997</i> and the <i>Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Imposition Act 1997</i> are invalid in their application to the superannuation entitlements of stipendiary magistrates of South Australia	Federal Court	Matter not yet progressed to hearing	

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Financial Year	Type of funding	Issue	Venue	Outcome of Court decision	Comments
05/06	Panel	Whether the applicant suffered 'serious hardship' under to section 340-5(3) of Schedule 1 of ITAA36 to release him from his tax debt.	Federal Court	Decision not yet handed down.	The issue is whether the taxpayer's current lifestyle is the benchmark for hardship.
05/06	Panel	Whether or not the taxpayer was a charitable institution.	Full Federal Court	N/A	Commissioner withdrew.
05/06	Panel	Calculation of GST on taxable supply of real property under the margin scheme.	AAT	Matter not yet progressed to hearing	
05/06	Panel	Application of Div 99 of the GST Act in relation to forfeited deposits	AAT	Commissioner successful	The taxpayer has appealed to the Federal Court and funding has been approved but terms not yet agreed with the taxpayer.
05/06	Panel	Whether the amounts taken as 'deposits' are deposits for the purposes of Div 99 of the GST Act.	N/A	Matter not yet progressed to court	
05/06	Panel	Whether the indexed pension paid from the Commonwealth Superannuation Scheme is a rebatable superannuation pension as defined in section 159SJ(1) ITAA36.	AAT	Matter not yet progressed to hearing	

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Financial Year	Type of funding	Issue	Venue	Outcome of Court decision	Comments
05/06	Panel	Whether the financial services provided to the taxpayer in relation to the floating of its shares on the Australian Stock Exchange constituted an "arrangement for the provision, acquisition or disposal of an interest in a security" for the purposes of item 9 of sub reg 70-5.02 of the GST Regulations.	AAT	Matter not yet progressed to hearing	
05/06	Panel	Whether the issue of shares issued to the Trustee of the Share Plan gave rise to a fringe benefit as defined under subs. 136(1) of FBT Act.	Federal Court	Taxpayer successful	The Commissioner has filed an appeal to the Full Federal Court.
05/06	Panel	Whether the in specie distribution of shares by the parent company to the respondent was a dividend paid out of profits derived by the company within the terms of s.44(1) of the <i>Income Tax Assessment Act 1936</i> ("the ITAA 1936") as applicable for the year ended 30 June 2000.	Federal Court	Decision not yet handed down.	This case was an appeal from the Administrative Appeals Tribunal
05/06	Panel	What is the correct test to be used in determining whether a taxpayer has "exclusive use" of business premises for the purposes of section 87-30(1)(b) of the ITAA97.	Federal Court	Matter not yet progressed to hearing	

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Financial Year	Type of funding	Issue	Venue	Outcome of Court decision	Comments
05/06	Panel	Whether circumstances relevant to the exercise of the remission discretion conferred by section 298-20 of the TAA are restricted to those relating to the conduct of the taxpayer or at least the taxpayer's circumstances; and Whether having regard to the separate provision in the TAA for the payment of general interest charge in respect of a tax shortfall, it is a relevant consideration in the exercise of the remission discretion that a refund of the tax shortfall amount in question was never made to the taxpayer.	Federal Court	Matter not yet progressed to hearing	
05/06	Panel	Whether the AAT had jurisdiction to direct the Commissioner to remit GIC Late Payment Penalty and Additional Tax for Incorrect Return Penalty.	Full Federal Court	Matter not yet progressed to hearing	
05/06	Panel	Whether the taxpayer should be released from his tax liability pursuant to section 340-5 of Schedule 1 of TAA53.	Federal Court	Matter not yet progressed to hearing	This case is an appeal from a decision of the Small Taxation Claims Tribunal

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Financial Year	Type of funding	Issue	Venue	Outcome of Court decision	Comments
05/06	Panel	Whether the taxpayer is a charitable institution within the meaning of Item 1.1 of section 50-5 of ITAA97, and thus is exempt from income tax.	Federal Court	Decision not yet handed down.	This case is an appeal from a decision of the Administrative Appeals Tribunal
05/06	Panel	Whether a payment was made in consequence of the 'dismissal' of the applicant pursuant to para 27F(1)(a) of the ITAA1936.	AAT	Matter not yet progressed to hearing	
05/06	Panel	Whether the applicant suffered 'serious hardship' under to section 340-5(3) of Schedule 1 of ITAA36 to release him from his tax debt.	Federal Court	Taxpayer successful	The case was appealed and funded by the Commissioner to gain further clarification on what constitutes serious hardship. The court decided that the Tribunal properly applied the correct legal test in reaching its finding that the applicant faced 'serious hardship'. The Commissioner has decided not to appeal the case.

ATTACHMENT 3: TEST CASE APPLICATIONS DECLINED (2003 - 2006)

Financial Year	Issue	Reason why funding was declined	Panel's reasoning
03/04	This case involved the liability of 'sleeping directors' and the taxpayer's appeal from the Full Federal Court decision in relation to the interlocutory application by the Commissioner to have the taxpayer indemnified pursuant to subsection 588FGA(2) of the Corporations Law.	Unlikely to provide law clarification	The Panel was of the opinion that the judgment of the Full Federal Court dealt comprehensively with the legal issues raised in this matter. The Panel stated that if the High Court were to grant special leave to hear the appeal the Panel would reconsider the taxpayer's application for test case funding. The Panel stated that if the High Court found that there was a basis for appeal that the submissions of the taxpayer should be reconsidered.
03/04	This case involves a Deed of Company Arrangement made under Part 5.3A of the <i>Corporations Act 2001</i> . The issues included: (a) whether the Commissioner should be treated the same as any other creditor so that the right of the Commissioner to make a set off is confined to that provided for in section 553C of the Corporations Act; and (b) whether sections 221YHG(2) of the ITAA 1936 enable the Commissioner to apply credits payable to the company against debts caught by the Deed on the basis that those sections apply irrespective of the operation of other legislation such as the Corporations Act.	Unlikely to provide law clarification	The Panel was of the view that the matter would not result in further clarification of the law. The Panel were of the view that the Full Court's decision provided a concise account of the relevant legal principles as applicable to the facts of the case. Funding was also declined because the legislative provisions under consideration in this case have been repealed. The new provisions dealing with the set-off of tax debts do not use the term "tax payable", on which the present case turns. The new set-off provisions expressly apply whether or not the tax in question is payable.

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Financial Year	Issue	Reason why funding was declined	Panel's reasoning
03/04	Whether the production and management fees relating to a scotch whiskey scheme were deductible under section 8-1 of ITAA97; and whether Part IVA applied.	Recent litigation on the same issue	The Panel were of the view that this matter raised issues which have been the subject of recent litigation (i.e. Vincent, Puzey, Sleight and Cooke & Jamieson). The case unlikely to add significantly to the jurisprudence in this area
03/04	Whether the AAT has jurisdiction to review the decision of the Commissioner refusing the taxpayer an extension of time to make an employee stock option election in respect of the 1998 year.	Unlikely to provide law clarification	The Panel were of the view that funding was not appropriate because the case did not meet any of the funding criteria. Most significantly, the Panel were of the view that his matter was unlikely to further clarify the law relating to the AAT's jurisdiction under Part IVC of the Tax Administration Act 1953.
03/04	Whether the Trustee of the Trust was required to transfer the Applicant's benefits to another regulated superannuation fund upon the Applicant's request.	Not Part IVC litigation - not tax technical	The issues raised in the case related to an alleged breach of the Superannuation Industry (Supervision) Act by an employer sponsored fund. These are regulated by the Australian Prudential Regulation Authority. The Commissioner only has responsibility for regulating the conduct of Self-managed Superannuation Funds.
03/04	The case involved issues relating to the application of Part IVA to disallow deductions associated with a mass marketed scheme in the agricultural sector.	Unlikely to provide law clarification	It was considered the case would not result in clarification of taxation law principles; and would not provide any precedential value.
03/04	Application of Part IVA to a tea tree oil project (agricultural project). Whether Payments made for management fees, licence fees and interest were deductible under section 51(1) ITAA36.	Unlikely to provide law clarification	The Panel were of the view that the case would not add significantly to the body of law relating to the application of Part IVA to 'business activities'. The case would not provide a precedent which will affect a significant section of the public or a significant industry as <i>Spotless</i> has settled this issue.

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Financial Year	Issue	Reason why funding was declined	Panel's reasoning
03/04	The application of Part IVA to an agricultural scheme and whether relevant outgoings were on revenue or capital account.	Unlikely to provide law clarification	Whilst this application was being considered, the Full Federal Court decision in Sleight and the High Court decision in Hart was handed down. These decisions provided substantial guidance on the application of Part IVA.
03/04	The case involves the application of Part IVA to disallow deductions associated with a mass marketed scheme in the agricultural sector. The matter also involves a determination as to whether expenses incurred are properly characterised as revenue or capital expenditure.	Unlikely to provide law clarification	Funding was declined because there were no issues raised that were of compelling or significant law clarification benefit. The case would not resolve any contentious issues raised in Public Rulings, and the precedential benefits of the case are limited to the particular facts of the scheme.
03/04	(1) Whether the applicant can choose to apply the margin scheme within the meaning of the section 75-5(1) of the GST Act in respect of supplies of real property by the applicant during the tax periods from 1 July 2000 to 30 Sept 2001; and (2) if the applicant did choose to apply the margin scheme, whether the applicant obtained a valid valuation of the relevant property within the meaning of subsection 75-10(3) of the GST Act.	Insufficient facts provided to determine if the case would provide law clarification	The matter was before the AAT. A decision of the AAT is not sufficiently precedential to warrant the grant of funding. Furthermore, not all the relevant facts, including the contract purportedly containing the election to apply the margin scheme, were not, at the time before the AAT. The applicants were invited to reapply for test case funding if the matter was going to be heard before a Presidential Member and if the AAT had the benefit of all of the relevant facts.

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Financial Year	Issue	Reason why funding was declined	Panel's reasoning
03/04	The issue raised in this case is whether an amendment to a discretionary trust deed, which substantially alters the beneficiaries, creates a new trust estate for the purposes of Division 6 of the Income Tax Assessment Act 1936 and whether a new trust is created over a CGT asset for the purposes of section 104-55 of the Income Tax Assessment Act 1997. The applicant also submitted that this case would assist in setting the parameters of the Commissioner's Statement of Principles issued in August 2001.	Unlikely to provide law clarification	While the Panel agreed that judicial consideration of the Statement of Principles could in an appropriate case provide guidance to the Commissioner and the community in applying section 104-55 and subdivision 40-D ITAA97, it was the Panel's view that an analysis and consideration of the facts would be an important aspect of such a case. The Panel also considered that an appeal based on a PBR limits the facts on which a court may consider those stated on the PBR. The Panel commented that a test case on the issue of trust settlement would ideally arise from an objection against an assessment rather than a PBR.
03/04	The matter concerned the deductibility of certain costs and expenses incurred by the taxpayer in relation to the conduct of conferences and seminars for its distributors. Whether expenses such as airfares, accommodation, meals, freight, stationery, gifts and samples were deductible as entertainment expenses under section 51AE of ITAA36.	Low relative importance of the issue combined with the financial capacity of taxpayer	Although the taxpayer's financial capacity to pursue litigation is not determinative, the Panel considered the relatively limited funding available to test the many tax issues that warrant testing, and after carefully considering the relative importance of this issue compared to the many tax issues that may need to be tested in the near future, and balancing these considerations with the apparent financial capacity of the taxpayer, the Panel by majority recommended that funding should be declined.
03/04	Whether the land acquired and held by the taxpayer was trading stock for the purposes of ITAA36.	Unlikely to provide law clarification	The Panel were of the view that the outcome of the case could ultimately turn on a question of fact, and concluded that this matter was not of relative significance to the administration of tax law and would not create a precedent affecting a significant industry or a significant section of the public.

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Financial Year	Issue	Reason why funding was declined	Panel's reasoning
03/04	Alienation of personal services income measure contained in Part 2-42 of ITAA97.	Unlikely to provide law clarification	This was a matter that was remitted back to the AAT by the Federal Court. The Panel were of the view that the matter would be determined on its facts at the AAT and that there was limited scope for clarification of the law.
03/04	Whether the taxpayer, who runs a business of hiring out houseboats to the public, are entitled to a fuel rebate.	Unlikely to provide law clarification	The Panel were of the view that the outcome would largely depend on the factual findings that the AAT comes to about the interpretation of the relevant contracts. In particular, the question of whether the taxpayer sold fuel to members of the public separately when hiring out houseboats is a question of fact.
03/04	Whether the District Court lacks jurisdiction to determine the issue of the validity of Directors Penalty Notice. That is, whether the District court has jurisdiction to hear federal taxation matters.	Not Part IVC litigation - not tax technical	The matter will not clarify the Commissioner's administration of the tax law. The matter is not instituted pursuant to Part IVC of the Tax Administration Act 1953, and therefore will not test any tax technical issue.
04/05	Whether the taxpayer can revoke a valid election made pursuant to section 139E of the ITAA36.	Unlikely to provide law clarification	The Panel were of the view that the case did not raise issues of relative importance to the general administration of the taxation system, nor will it create precedent applicable to a significant number of taxpayers.
04/05	Whether the supply of goods purchased with interest free finance is a mixed supply, a composite supply or two supplies under the GST Act.	Low relative importance of the issue combined with the financial capacity of taxpayer	Although the taxpayer's financial capacity to pursue litigation is not determinative, the Panel considered the relatively limited funding available to test the many tax issues that warrant testing, and after carefully considering the relative importance of this issue compared to the many tax issues that may need to be tested in the near future, and balancing these considerations with the apparent financial capacity of the taxpayer, the Panel by majority recommended that funding should be declined.

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Financial Year	Issue	Reason why funding was declined	Panel's reasoning
04/05	Whether a non-resident tour operator, is making a taxable supply under section 9-5 of the GST Act when it sells rights to accommodation in Australia.	Unlikely to provide law clarification	The Panel were of the view that as there was no specific case in court, they were not satisfied that any legal precedent would be established that would affect a significant section of the public. The Panel were concerned that the issues raised may tend to turn on the particular facts of the case. It was for that reason that agreement in principle was not given, but the applicant was advised that the Panel would happily reconsider the position if an actual case was provided for consideration.
04/05	The litigation was in respect of the 'no ABN withholding tax' provisions contained in the GST Act.	Retrospective application	The matter had already been litigated, and it was not appropriate in this case to grant funding retrospectively. None of the criteria for funding was met.
04/05	Whether the lodgment of a Business Activity Statement resulting in a refund under section 35-5 of the GST Act would compel the Commissioner to issue the refund within 14 days of lodgment of the BAS.	Insufficient facts provided to determine if the case would provide law clarification	Funding was denied because of the paucity of information contained in the application, the taxpayer failed to demonstrate the relative importance of the issues raised by the case. The Panel was not persuaded that the case would provide legal precedent that will affect a significant section of the public.
04/05	The application of the income injection test in Division 270 of Schedule 2F of the ITAA97, including the meaning of the terms benefit, provide and under a scheme as used in that Division	Unlikely to provide law clarification	Funding was requested for the appeal of an AAT decision that was adverse to the taxpayer. The Panel were of the view that the AAT decision (comprising two Deputy Presidents and a Senior Member) provided a comprehensive decision consistent with the underlying policy of the law. The appeal was not directed to resolving uncertainty in the law.

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Financial Year	Issue	Reason why funding was declined	Panel's reasoning
04/05	Home loan unit trust arrangement. Whether the interest incurred by the unit trust as a consequence of purchasing a residential home is deductible pursuant to section 8-1 of ITAA97; or whether Part IVA applied to deny such deductibility.	Unlikely to provide law clarification combined with tax avoidance	The application for funding was for funding in principle. The issues that were mentioned in the application would largely be determined on the facts of the particular case . In the absence of a particular case to be considered, it was not possible to identify what tax issues would be resolved that would be of importance to the general administration of the taxation system. Further, the matter involved a tax avoidance scheme.
04/05	Whether the taxpayer, who runs a business of hiring out houseboats to the public, are entitled to a fuel rebate.	Unlikely to provide law clarification	The Panel were of the view that the outcome would largely depend on the factual findings that the AAT comes to about the interpretation of the relevant contracts. In particular, the question of whether the taxpayer sold fuel to members of the public separately when hiring out houseboats is a question of fact.
04/05	Whether section 8 of the Superannuation Contributions (Assessment and Collection) Act 1997 permits the notional surchargeable contributions factor determined by an actuary for a defined benefit superannuation fund to be expressed as a dollar amount.	Low relative importance of the issue combined with the financial capacity of taxpayer	Low relative importance of the issue combined with the financial capacity of taxpayer

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Financial Year	Issue	Reason why funding was declined	Panel's reasoning
04/05	Whether or not the taxpayer made an election or choice to use the margin scheme.	Unlikely to provide law clarification	The Panel were not persuaded that the case would clearly test issues of relative importance as the case will ultimately turn on findings of fact. The important question of whether there are any restrictions on when the choice to apply the margin scheme can be made will not be tested in the case. The case will turn on evidence about what the vendor did, and in particular, whether the vendor chose to apply the margin scheme at or before the settlement date.
04/05	Whether a range of beverages produced by the taxpayer did not come within the definition of a "grape wine products" as defined in section 31-3 of the WET Act or whether the products came within the definition of "other excisable beverage" in the <i>Excise Tariff Act 1921</i> .	Unlikely to provide law clarification	The Panel recommended that the application was not of relative importance to the general administration of the taxation system. The Panel were also of the view that the issues raised in the case had relatively limited application to other taxpayers and, as a matter to be heard before the AAT, will lack precedential value.
04/05	The issue was whether the taxpayer is an Income Tax Exempt Charity pursuant to Item 1.1 of s50-5 of the ITAA 1997.	Unlikely to provide law clarification	The Panel recommended that the application be declined on the basis that the question in issue is largely the application of facts to the law that presently exists. Further, the Panel were unable to find something extraordinary about this matter to warrant a grant of funding.
04/05	Whether the taxpayer was a charitable institution, a non-profit society for community service purposes or a public benevolent institution during the period from 1 July 1989 to 30 June 1999 or part thereof?	Unlikely to provide law clarification	The Panel recommended that the application for Test Case funding be declined on the basis that the case would not add any precedential value to the already extensive body of law on the issues of public benevolent institutions and charitable institutions. The Panel could not identify technical issues that would add to this body of law. The case seemed to turn entirely on how the facts will be applied to well established principles.

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Financial Year	Issue	Reason why funding was declined	Panel's reasoning
04/05	Whether management fees received should be included in assessable income under section 6-5 ITAA97. When is the income from the management fees considered to be 'derived' where the receipt of the income is subject to a condition.	Unlikely to provide law clarification	The Panel were of the view that there was no compelling public interest to fund the case. The case would be answered on its facts, by reference to well established principles.
04/05	Whether deductions relating to a franchising scheme were allowable under section 8-1 ITAA97.	Unlikely to provide law clarification	The Panel was not persuaded that the case would clearly test issues of relative importance as the case would ultimately turn on the application of well established legal principles to the findings of fact. The Panel was of the view that the transactions which were the subject of the litigation involved attempts to gain benefits not intended by the legislation.
04/05	Whether GST is payable following a rent review under a lease agreement pursuant to section 13 of the GST Transition Act.	Recent litigation on the same issue	The issues were raised in a case which was before the Full Federal Court at the time (D B Reef Funds Management Ltd). The Panel felt it was premature to decide whether the application should be funded. The Panel decided to wait until the outcome of the appeal in D B Reef to determine the application. The Panel will reconsider the application after the appeal has been determined.
04/05	What was the amount of GST under a contract for the sale of land.	Not Part IVC litigation - not tax technical	The Panel was of the view that proceedings involving a contractual dispute between parties is not a suitable vehicle for funding under the Program. The dispute was not brought under Part IVC of the Tax Administration Act 1953.

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Financial Year	Issue	Reason why funding was declined	Panel's reasoning
05/06	What degree of specificity is required by section 38-325(1) of GST Act? Is the fact that the sale agreement itself is in writing and that the agreement amounts to the supply of a going concern for the purposes of section 38-325(2) sufficient.	Unlikely to provide law clarification	The question at issue was largely a question of fact. The Panel were of the view that the case lacks the degree of uncertainty or contention necessary for the grant of funding.
05/06	The issue was whether the taxpayer is an Income Tax Exempt Charity pursuant to Item 1.1 of s50-5 of the ITAA 1997.	Unlikely to provide law clarification	The Panel declined funding on the basis that the question in issue was largely the application of facts to the law that presently exists. Further, the Panel were unable to find something extraordinary about this matter to warrant a grant of funding.
05/06	In relation to debt collection costs and due diligence costs, whether the taxpayer, being an entity that made only input tax supplies should be entitled to full input tax credit relief.	Commissioner opposed special leave application	This was a special leave application which the Commissioner was opposing. The Full Federal Court is the final court of appeal in tax matters in all but exceptional cases. If the High Court granted special leave, the Panel would reconsider the application.
05/06	GST Margin scheme - valid valuations of off the plan sales.	Unlikely to provide law clarification	<p>(i) The issue sought to be tested related to a transitional provision. Any judicial decision would provide little precedential value over time considering the issue related to pre-GST property and a sunset limitation period of four years pursuant to section 35 of the Taxation Administration Act 1953 applied to the transaction.</p> <p>(ii) The issue did not impact on a substantial segment of the public as it would only impact upon taxpayers who were applying to the margin scheme to off-the-plan-sales of pre-GST held property.</p> <p>(iii) The panel noted the financial capacity of the applicants to independently fund the litigation.</p>

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Financial Year	Issue	Reason why funding was declined	Panel's reasoning
05/06	Application of Part IVA to a tea tree oil project (agricultural project). Whether Payments made for management fees, licence fees and interest were deductible under section 51(1) ITAA36.	Unlikely to provide law clarification combined with tax avoidance	The Panel was of the view that the matters on appeal all related to the application of well established legal principles to the findings of fact. The case also involved a tax avoidance scheme.
05/06	Whether the taxpayer satisfied the business premises test contained in section 87-30 ITAA97.	Unlikely to provide law clarification	The decision would turn on its facts, providing little precedential value to other taxpayers.
05/06	Whether interest deductions relating to a unit trust were deductible under section 8-1 ITAA97. Whether Part IVA applied to deny the deductions.	Unlikely to provide law clarification	The Panel were of the view that no one test case would be truly representative of other cases with similar arrangements because of the variability in facts between cases. The Panel concluded that the decision would largely turn on a question of fact unlikely to provide a principle that could be applied to a significant or substantial segment of the public.
05/06	Whether the taxpayer was entitled to claim input tax credits in respect of the acquisition of the property. Whether the anti avoidance provisions in the GST Act apply to deny the credits.	Unlikely to provide law clarification	The case raised general anti-avoidance provisions in the GST Act. The Panel was of the view that the facts of the case were so blatant that it would have been unlikely to raise significant legal questions, but more likely to be determined on a simple application of the facts to the plain meaning of the law.
05/06	Whether expenses relating to an agricultural project were deductible under section 8-1 ITAA97. Whether Part IVA applied to deny the deductions.	Unlikely to provide law clarification	The issues to be considered were largely factual, and turn on well established principles.
05/06	The application of Div 7A of the ITAA36 to beneficial transfers of property.	Unlikely to provide law clarification	The issues do not test any uncertainty or ambiguity in the legislation or raise significant issues requiring clarification.

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Financial Year	Issue	Reason why funding was declined	Panel's reasoning
05/06	Whether the AAT made an error of law in determining that a family trust arrangement had trust income pursuant to s.97 of the ITAA 1936. Further, that the default beneficiaries of the Trust (the taxpayers) were assessable on that trust income.	Unlikely to provide law clarification	The Panel was concerned that due to the paucity of evidence at first instance, the Federal Court may decide the case on accounting principles without needing to deal with the trust law issues. The Panel believed there was a possibility that the Federal Court may remit the matter back to the AAT to find further facts. In conclusion, the Panel considered that although the matter could potentially raise significant issues there was no certainty that the issues would be tested due to the current state of the evidence found by the Tribunal that would be before the Court. Although funding was declined, the Panel recommended that the case be reconsidered if important legal issues are clearly to be dealt with in future proceedings before the court.
05/06	Whether the taxpayers were carrying on a business of hiring out their boat for the purpose of gaining or producing assessable income at all relevant times in the income years in question.	Unlikely to provide law clarification	The Panel were of the view that the issue centred upon a factual question such as whether the taxpayer was carrying on a business. The applicant's appeal do not disclose a significant question of law. The Panel did not believe there was any doubt about the law relating to the carrying on of a business.
05/06	Whether interest deductions associated with a unit trust arrangement were outgoings of a private or domestic nature and therefore not deductible under s8-1 of the ITAA 1997; whether Part IVA applied to the arrangement denying deductibility of the interest deductions.	Unlikely to provide law clarification	Panel considered that no one test case would be truly representative of other cases with similar arrangements because of the variability in facts between the cases. The Panel also considered that the avoidance aspects of the arrangements in issue and the fact that the case is being pursued in the Administrative Appeals Tribunal was not the type of case the program tested. The Panel noted that there were cases currently before the Federal Court involving the unit trust arrangements which would provide judicial guidance on the issues.

ATTACHMENT 3

Financial Year	Issue	Reason why funding was declined	Panel's reasoning
05/06	1) Whether the self education expenses were incurred by the Applicant in gaining or producing her assessable income, so that they were deductible under subsection 8-1(1) of the ITAA 1997; and 2) If the self education expenses were incurred in gaining or producing the Applicant's assessable income, whether the expenses were of a private or domestic nature, and as such, not deductible pursuant to subsection 8-1(2) of the ITAA 1997.	Unlikely to provide law clarification	The Panel determined that the legal principles underlying these provisions are very well established and there is already a body of case law which comprehensively deals with the subject of self education expenses. The Panel was not persuaded that the matter raised any important legal principle that required clarification or raised any new previously unexplored issues that required testing.
05/06	Whether the receipt of an eligible termination payment from an employer after the taxpayer was not reappointed to a series of fixed-term contracts was a bona fide redundancy payment within the meaning of section 27F of the ITAA 1936? In particular, whether the taxpayer's termination of employment would "necessarily" have occurred on the end date of the current contract and accordingly the taxpayer was not terminated prior to that date.	Unlikely to provide law clarification	The Panel was not persuaded that the issue was likely to clarify the law for a significant number of taxpayers. The Panel were of the view that there was already a body of case law which provided guidance on the meaning of when someone is "dismissed" and notes that this will turn on the particular facts of each individual case. The Panel was not persuaded that the appeal will resolve uncertainty or contention about the law for a substantial segment of the community.

ATTACHMENT 4: ANALYSIS OF CAUSES OF REFUNDS FROM INDIVIDUAL TAX RETURNS

The item referred to as Individuals Refunds in the 2004-05 Annual Report totalling \$15.1 billion consisted of two main components. The largest component, totalling \$13.7 billion, arose from the processing of 2003-04 returns. The remainder, \$1.4 billion, arose from the processing of returns lodged late for prior years.

We have analysed the refunds from the 2003-04 returns in more detail in order to give the Committee an understanding of the causes of refunds. Although we have not analysed the \$1.4 billion flowing from returns lodged in respect of prior years, the same principles apply, and it is likely that the same patterns would emerge from any such analysis.

REFUNDS RESULTING FROM 2003-04 RETURNS

Refunds flowed to 8.35 million taxpayers who lodged for 2003-4 by 30 June 2005¹². These refunds consisted of two major components. The first was a true refund of contributions already paid by the taxpayer, either through various withholdings, the main one being Pay As You Go Withholding (PAYG(W)) from salary and wages, or through Pay As You Go Instalments (PAYG(I)) direct from the taxpayer. The amount of contributions refunded totalled almost \$9.9 billion dollars out of \$71.5 billion withheld, or 13.9%. This component made up 78.1% of the refund total. This component is further analysed below under **Refund Component 1**.

The second component consisted of payments of Refundable Tax Offsets, Family Tax Benefit and other credits that accrued to the taxpayer, but which had not previously been withheld from taxpayer income. Since the taxpayer did not contribute these amounts, they are not true 'refunds', but they are nevertheless included in the definition. They totalled almost \$3 billion, or 21.9% of the refund total. This component is further analysed below under **Refund Component 2**.

The scale of these components relative to the other amounts relevant to the tax calculation can be seen from Chart 1.

Refund Component 1

The Pay As You Go Withholding - PAYG(W) - system requires that amounts be withheld and remitted to the Tax Office by payers (employers) from certain payments to payees (individuals) to cover end of year tax liabilities. For the majority of taxpayers the payer withholds this amount based on withholding schedules prepared by the Tax Office.

The withholding schedules are built on the basis of gross income, that is, a tax instalment deduction is withheld according to the level of gross income the employee has earned in the relevant time period.

The withholding schedules do not result in a "precise" collection over the income year as they do not account for deductions, or tax offsets. In addition, the schedules have "built-in" a very

¹² The subsequent figures provided in this report relate to refund returns (only) for 2003-04 processed by 30 June 2005.

small amount of over withholding. This results in taxpayers receiving a refund of amounts previously collected by their employer (payer).

Refunds of amounts previously collected are generated by the overall tax calculation. In order to address the Committee’s interests we have separated them into the following components:

- 1 The application of deductions and losses to gross income in the tax return.
- 2 Over-withholding or contribution in the first instance.
- 3 The application of tax offsets, either claimed in the tax return or applied by the Tax Office.

Explanations of each follow.

Deductions and prior year losses

We have estimated this at \$5.23 billion, or 38.3% of the total refund amount. This is the biggest component.

Deductions reduce assessable income. As mentioned above Pay As You Go (W) is calculated on gross income. This interaction means that deductions will often cause over-withholding.

In 2003-04 the amount included in tax returns for deductions and losses was \$52.6 billion, or approximately 16% of gross income. Most of this was not claimed via reduced withholdings, and so led to refunded withholding credits. Table 1 itemises these deductions and losses, while Chart 3 displays them graphically.

Table 1 – Deductions and prior year losses 2003-04

Deduction	Amount (\$m)
Business Deductions	23,334.7
Rental deductions	12,837.9
Work-related expenses	9,530.0
Undeducted purchase price of pensions or annuities	1,275.4
Interest & Dividend deductions	1,107.8
Cost of managing tax affairs	789.6
Gifts or donations	785.2
Non-employer sponsored super contributions	733.3
Other deductions	705.5
Low value pool deduction	69.3
Aust. Film industry incentives	15.1
Deduction for project pool	1.8
Total Deductions	51,185.8
Tax losses of prior years	1,413.0
Total Deductions and prior year losses	52,598.8

Deductions do not flow directly into refunds. They are subtracted from gross income to derive taxable income, on which tax, Medicare levy (and surcharge) and higher education repayments are calculated. Their effect on refunds thus takes into account the marginal tax rate of the

individual, and residual tax payable. We have estimated that the \$52.6 billion claimed resulted in \$5.23 billion of refunds.

Over-withholding or contribution

We have estimated this at \$3.84 billion, or 28.1% of the total refund amount.

The withholding schedules are based on a person holding the same income level over the whole income year. Where an individual has 'lumpy' income for the year, the amount of tax instalments withheld are unlikely to match the end of year liability.

Over-withholding may occur when:

- people who lose employment for a period or who recommence employment for only part of the year may not achieve the full-year marginal tax rate built into the withholding scales. If the same people also ask their employers to withhold extra for anticipated higher education liabilities, this may further increase their refund.
- some people who have a second job and declare it to their employer will have a flat rate withholding that may be higher than their end of year marginal tax rate. (Note that it is also likely that others with multiple jobs will not have enough withheld)
- people who are promoted during the year will have their withholdings increased, but the scales will assume that this income was received on a full-year basis, with a higher average tax rate
- other people have variable income that does not match the underlying assumptions built into the withholding scales.

Note that there are also reasons why individuals may not have enough tax withheld through the withholding schedules.

Tax Offsets

Tax Offsets act primarily to reduce tax liability (they cannot reduce the Medicare levy or surcharge liability), and only give rise to a refund to the extent that net tax liability is non-zero and available credits exceed tax liability. A few tax offsets are refundable in their own right and are therefore not subject to the first condition. They are dealt with under **Refund Component 2** below.

In this analysis, deductions and losses, occurring before offsets in the tax calculation, are held to generate refunds of withholding credits before the application of offsets, and so the refund effect ascribed to offsets is lower than total offsets allowed. Of the \$3.8 billion claimed, \$0.43 billion was set aside because no further tax was payable, \$2.6 billion went to reducing tax liability and the remaining \$0.8 billion flowed through to refunds.

Table 2 itemises the tax offsets claimed in 2003-04 tax returns together with the total amount credited, while Chart 4 displays them graphically.

Table 2 – Tax Offsets 2003-04

Tax offset	Amount (\$m)
Termination payment rebate	868.4
Senior Australians	739.1
Low income rebate	537.2
Super Contributions - annuity & pension	368.1
Spouse etc rebate	350.4
Pension rebate	348.8
20% tax offset on net medical expenses	202.3
Zone or overseas forces	180.0
Government allowances rebate	98.6
Foreign tax credits	55.6
Averaging rebate	16.9
Parent/Spouses parent etc	15.2
Super contributions for spouse	11.9
Other tax offsets	6.9
Life Assurance bonus rebate	1.4
Land & water facility - tax offset brought forward	0.04
Total Offset Claimed	3,801.2
Total Offset Limited To Gross Tax	3,363.3

Refund Component 2

This component is comprised of seven items, being three refundable tax offsets, three refundable credits, and Family Tax Benefit. They are listed in Table 3. They flow directly into refunds unless the taxpayer has insufficient other credits to pay their final liability, in which case some or all is offset against the liability.

Table 3 – Refundable tax offsets or credits claimed 2003-04

Refundable tax offset or credit	Amount (\$m)
Dividend imputation credit	1,969.9
Dividend imputation credit from partnerships and trusts	651.7
First child tax offset (Baby Bonus)	232.3
Private health insurance rebate	136.9
Foreign income - Aust. Franking Credit from NZ	0.6
Credit for interest on early payment of tax	0.09
Total Refundable Tax Offsets claimed	2,991.4
Family Tax Benefit	1,114.4
Total	4,105.8

Chart 2, which is an enlarged version of Chart 1, shows the totals of the above refund sub-components relative to the withheld amounts retained to meet tax, Medicare and higher education liabilities.

Further analysis

In order to show the variable incidence of the above components on taxpayers we have separated taxpayers with refunds in 2003-04 tax returns into three groups:

ATTACHMENT 4

- Group N: Those with **no** withholding from salary and no PAYG-I instalments: 771,000 taxpayers.
- Group S: Those with a **shortfall** of withholding credits and PAYG-I instalments with reference to gross income: 3.023 million taxpayers.
- Group E: Those with an **excess** of withholding credits and PAYG-I instalments with reference to gross income: 4.558 million taxpayers

The components of the tax calculation for each are shown graphically in Charts 5 to 7, following the same presentation as for the total population in Chart 2.

Group N - see Chart 5

Points to note about this group:

- average gross income was low at \$14,398
- average taxable income was \$6,949
- most income came from sources not subject to withholding: only 5% from salary and wages, while the families, investors and seniors segments were heavily represented.
- only 11.8% of this income was nominally subject to withholding at source, with a further 6% being subject to partial or optional withholding
- deductions and losses were 51.7% of gross income
- tax offsets were 51.2% of gross tax payable
- withholding credits fell short of final liability by \$298 million
- the total refund was therefore all attributable to Refund Component 2 (refundable tax offsets, family tax benefit & credits), but some (28.5%) was retained to meet the tax liability.

This group clearly did not have excess withholding credits deducted.

Group S – see Chart 6

Points to note about this group:

- average gross income was \$56,034
- average taxable income was \$42,637
- at least 71% of this income was nominally subject to withholding at source, with 66% being from salary and wages
- deductions and losses were 23.9% of gross income
- tax offsets were 6.8% of gross tax payable
- 11% of withholding credits were refunded, totalling \$3.4 billion
- the excess credits were attributable to deductions and losses being claimed
- the remainder of the refund was generated by Refund Component 2, totalling \$2.2 billion.

The deductions and losses claimed in returns were sufficient to not only make up for the initial shortfall of withholding credits, but also generated 60% of the total refund amount for the group.

Group E – see Chart 7

Points to note about this group:

- average gross income was \$31,533
- average taxable income was \$30,138
- over 94% of this income was nominally subject to withholding at source, being predominantly from salary and wages
- deductions and losses were 4.4% of gross income
- tax offsets were 2.8% of gross tax payable
- 17.9% of withholding credits were refunded, totalling \$6.5 billion
- the excess credits were attributable to:
 - excess withholding \$3.83 billion (59% of credits)
 - deductions and losses \$1.86 billion (28.6%)
 - tax offsets \$0.8 billion (12.3%)
- the remainder of the refund was generated by Refund Component 2, totalling \$0.8 billion.

Even had this group claimed its deductions in advance, it would still have had excess withholding credits.

Summary comparisons

Table 4 shows the break-down of each group by population sub-segment (with the exception of seniors and youth these are not mutually exclusive sub-segments).

Table 4 – Membership of population sub-segments

Group	Business income	Employees	Families	Investors	Seniors	Youth	Non-Residents
N	55,718	43,331	605,511	577,755	421,159	52,001	1,781
S	337,294	2,600,445	1,838,645	1,712,671	666,117	262,767	2,110
E	66,522	4,369,772	2,188,897	944,790	420,030	1,197,446	10,749
Total	459,534	7,013,548	4,633,053	3,235,216	1,507,306	1,512,214	14,640
Percentages of sub-segment totals							
N	12.12	0.62	13.07	17.86	27.94	3.44	12.17
S	73.40	37.08	39.69	52.94	44.19	17.38	14.41
E	14.48	62.30	47.25	29.20	27.87	79.18	73.42
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00

It can be seen that individuals in receipt of business income and investors are predominantly in group S, the lack of withholding on a significant proportion of this income, particularly the business income, in part explaining the shortfall. Employees, non-residents and youth are predominantly in Group E.

Charts 8 and 9 compare the components for each group. It can be seen from Chart 9 that while the group refund shares align reasonably closely with group population, their derivations differ in some significant respects. Group S dominates the share of deductions & losses, tax offsets and other credits and refundable tax offsets, while Group E dominates in higher education repayment liability. This latter effect is likely due to part of this group having made

arrangements for higher withholding payments to meet this extra liability – the Youth sub-segment is much more heavily represented in this group.

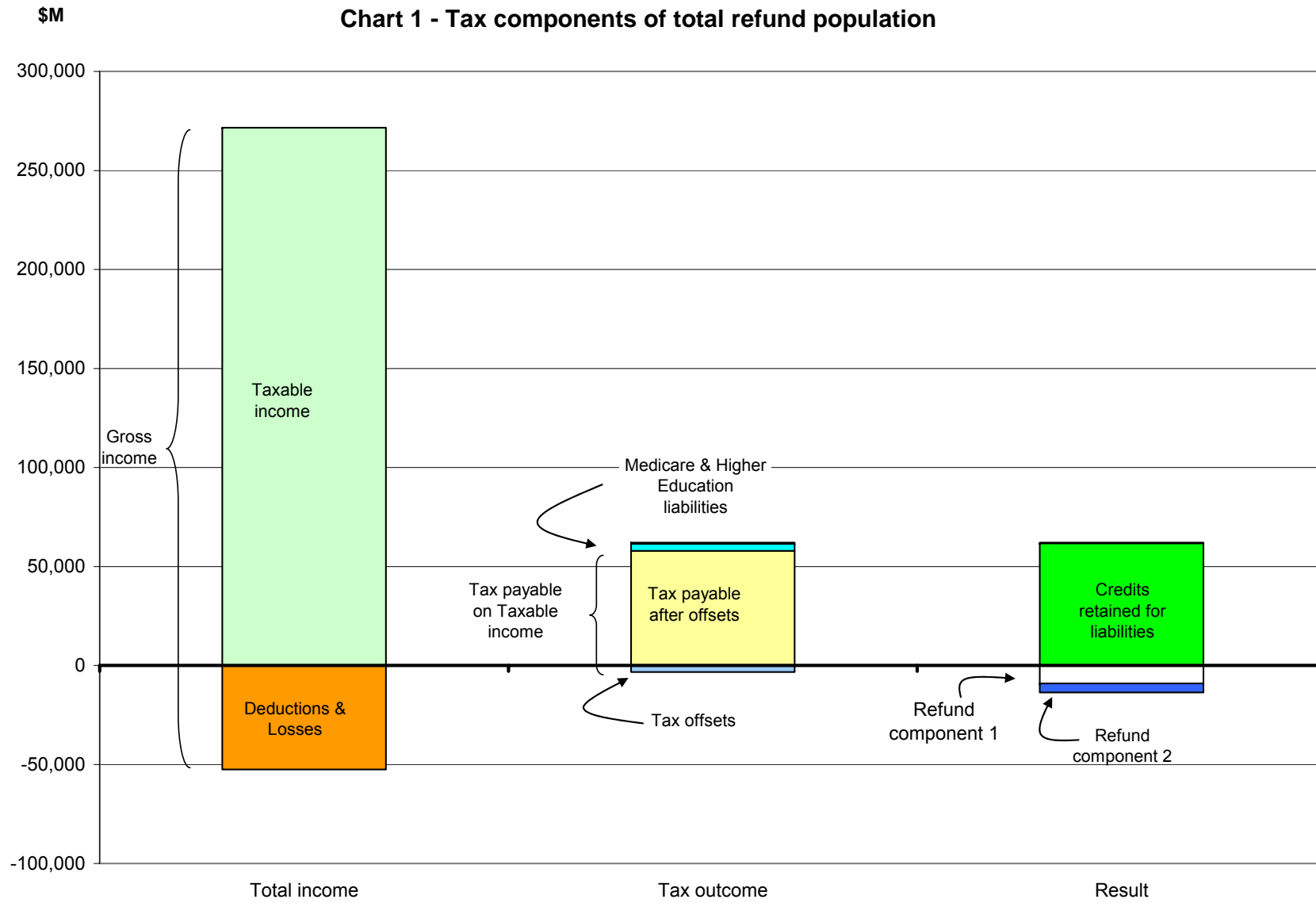


Chart 2 - Expanded view of tax components of total refund population

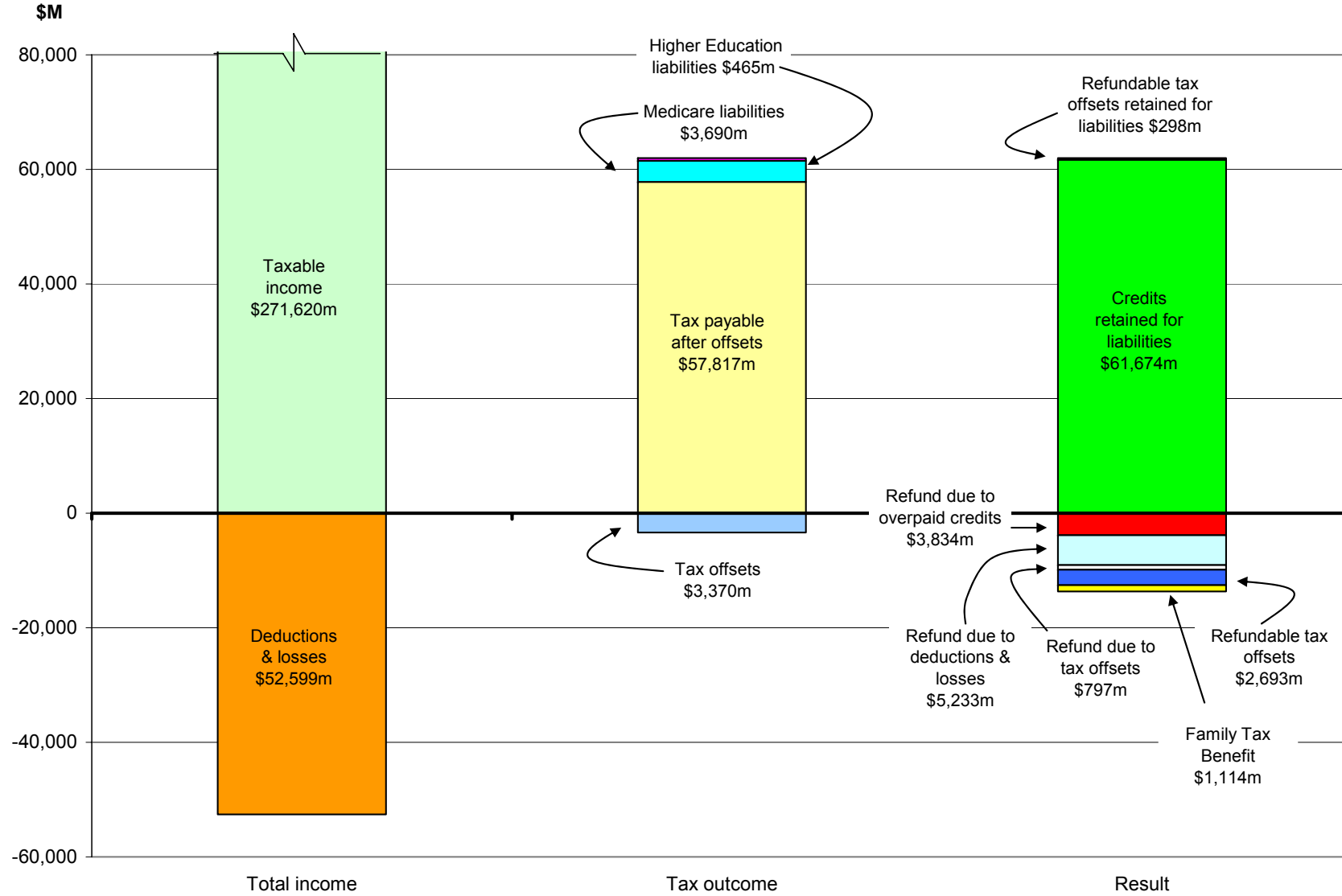


Chart 3 - Deductions and Losses 2003-04

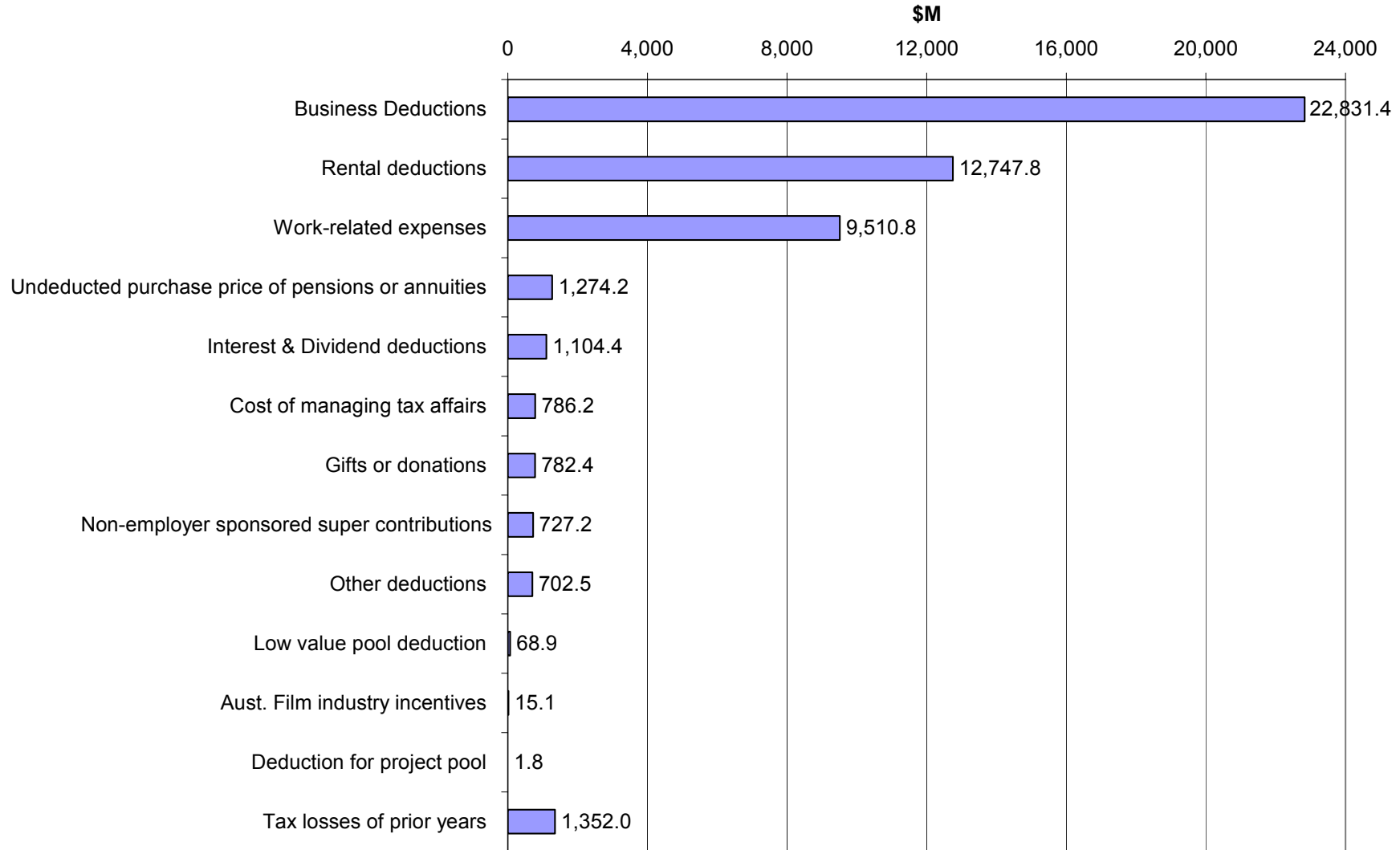


Chart 4 - Tax offsets claimed 2003-04

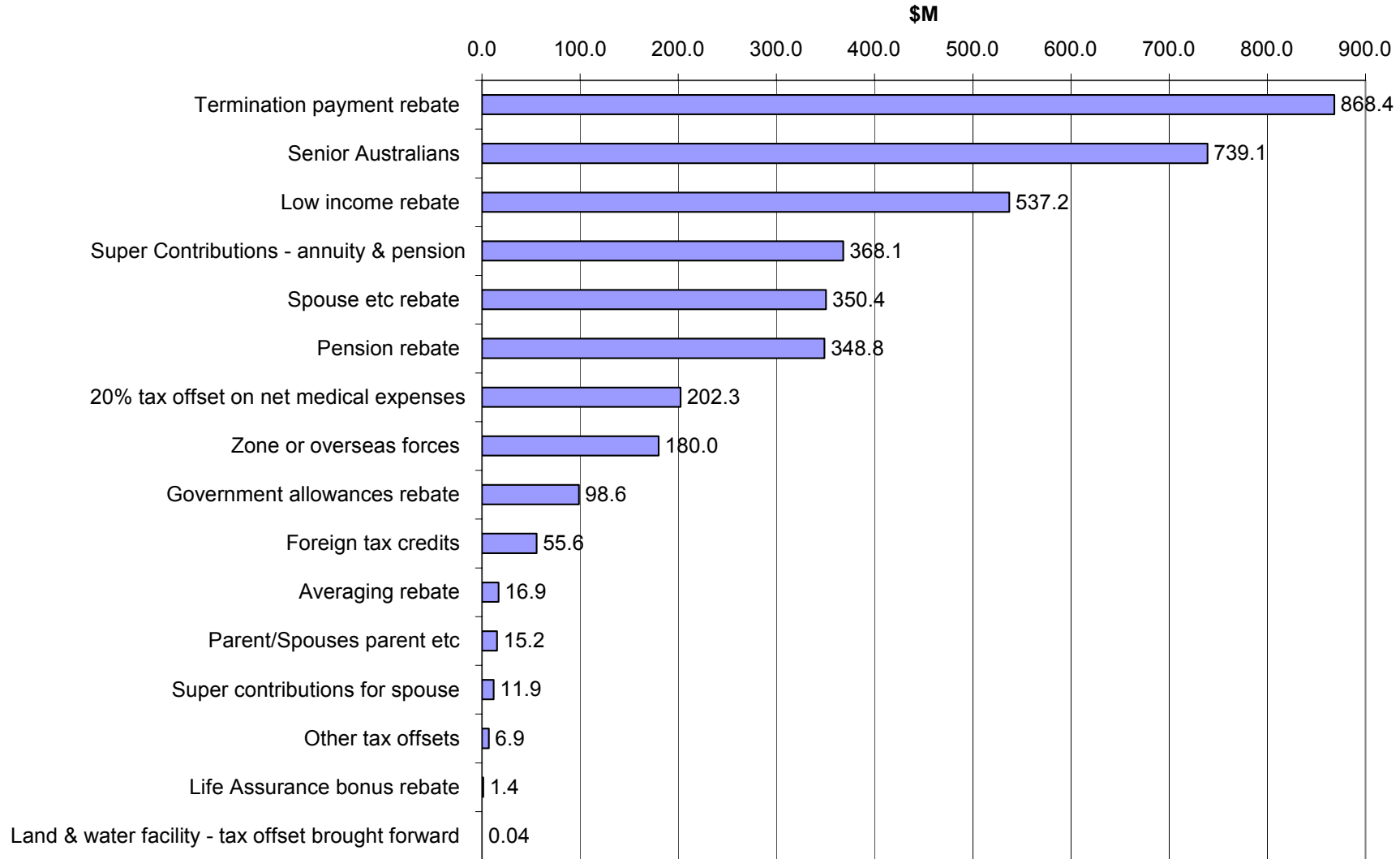


Chart 5 - Group N (no withholding on salary, or instalments)

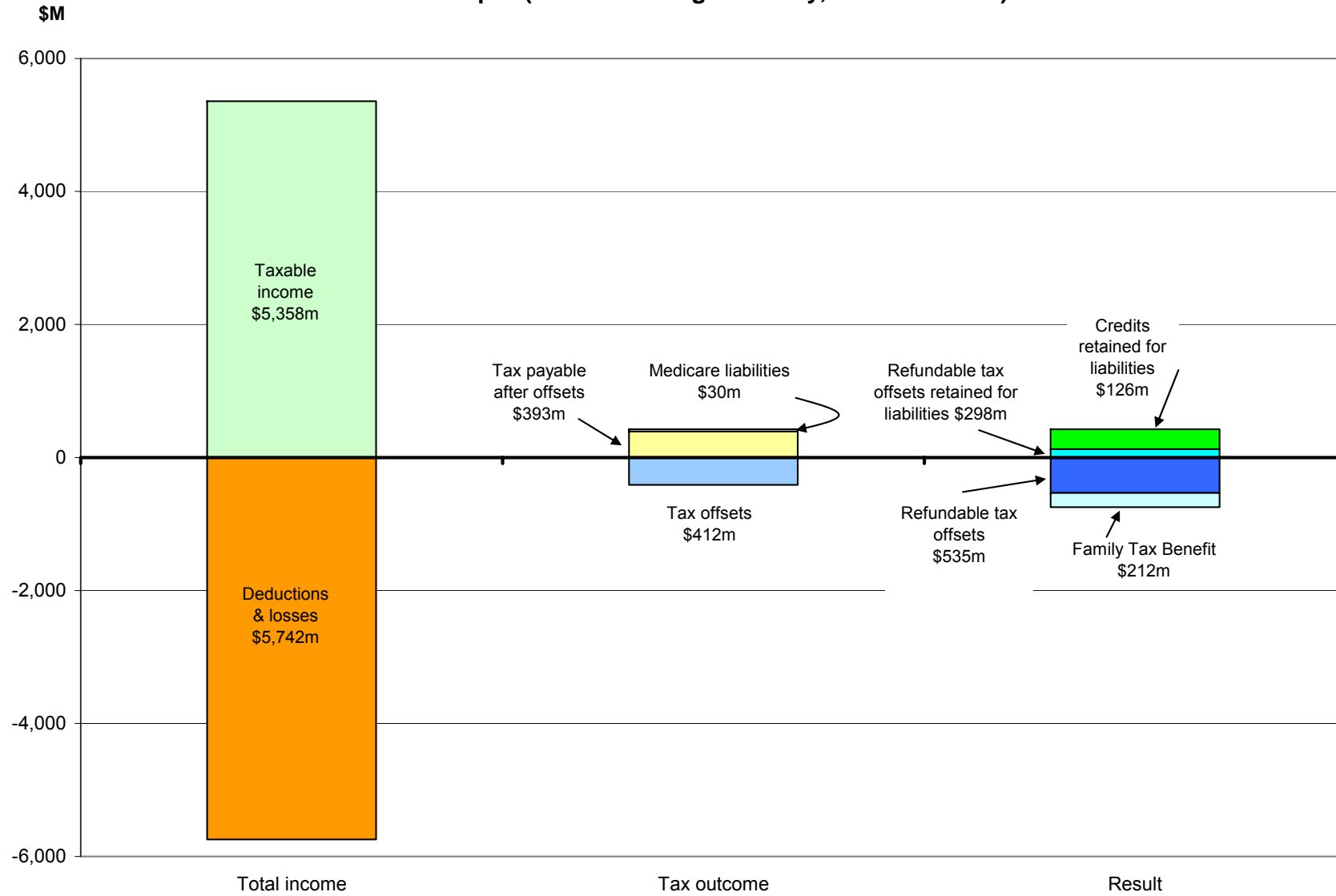


Chart 6 - Group S (Initial shortfall of credits from salary withholding & instalments)

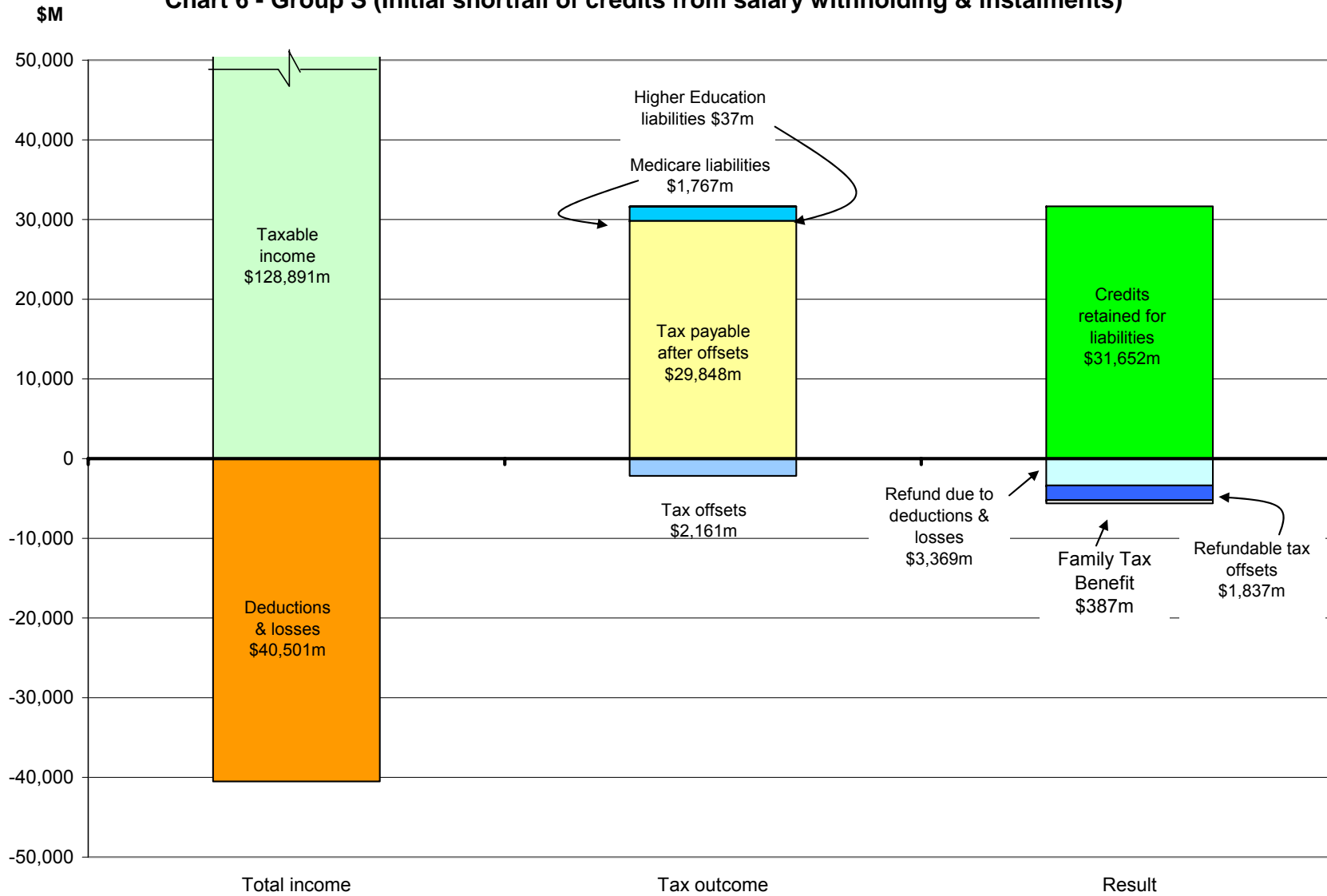
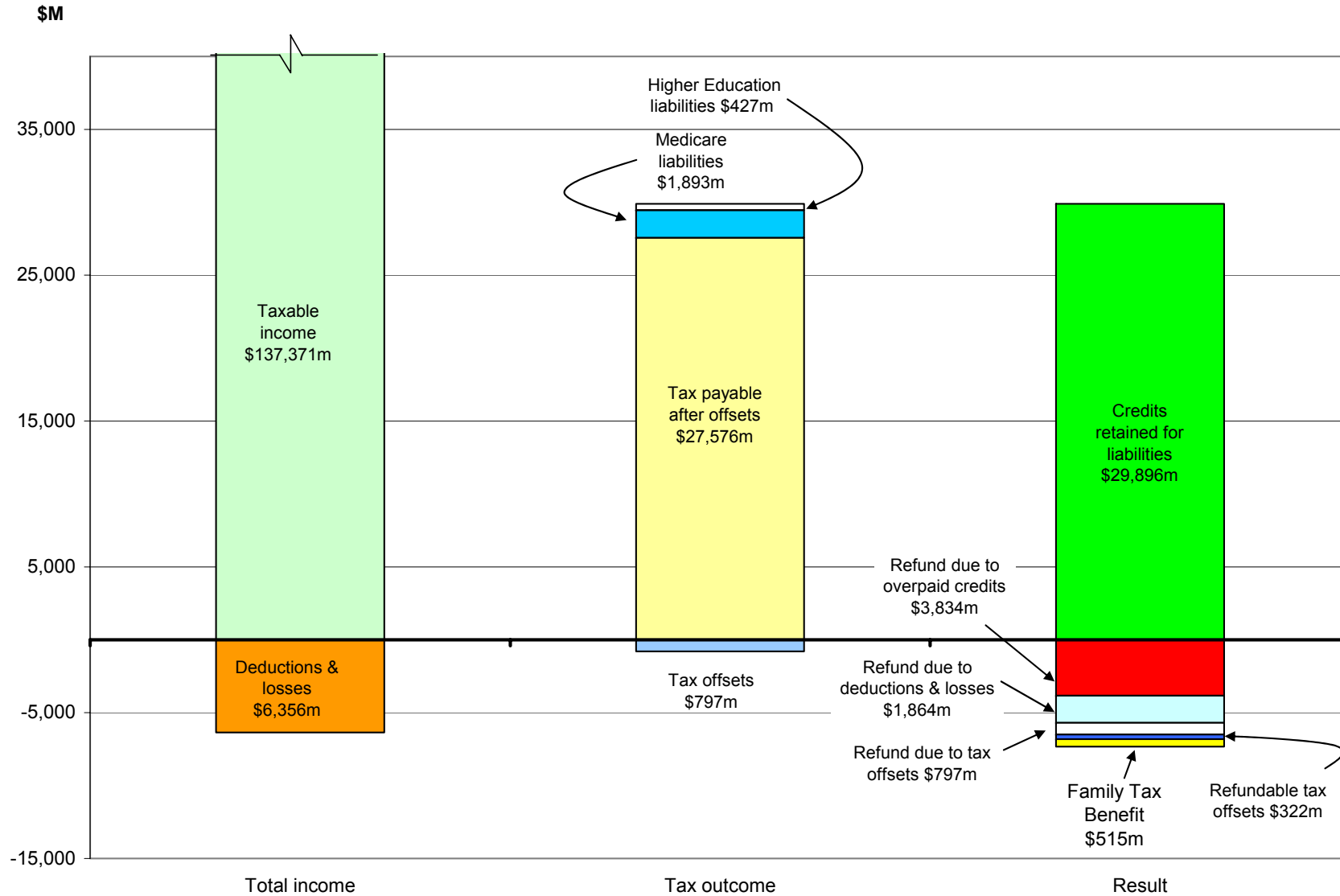


Chart 7 - Group E (Initial excess of credits from salary withholding & instalments)



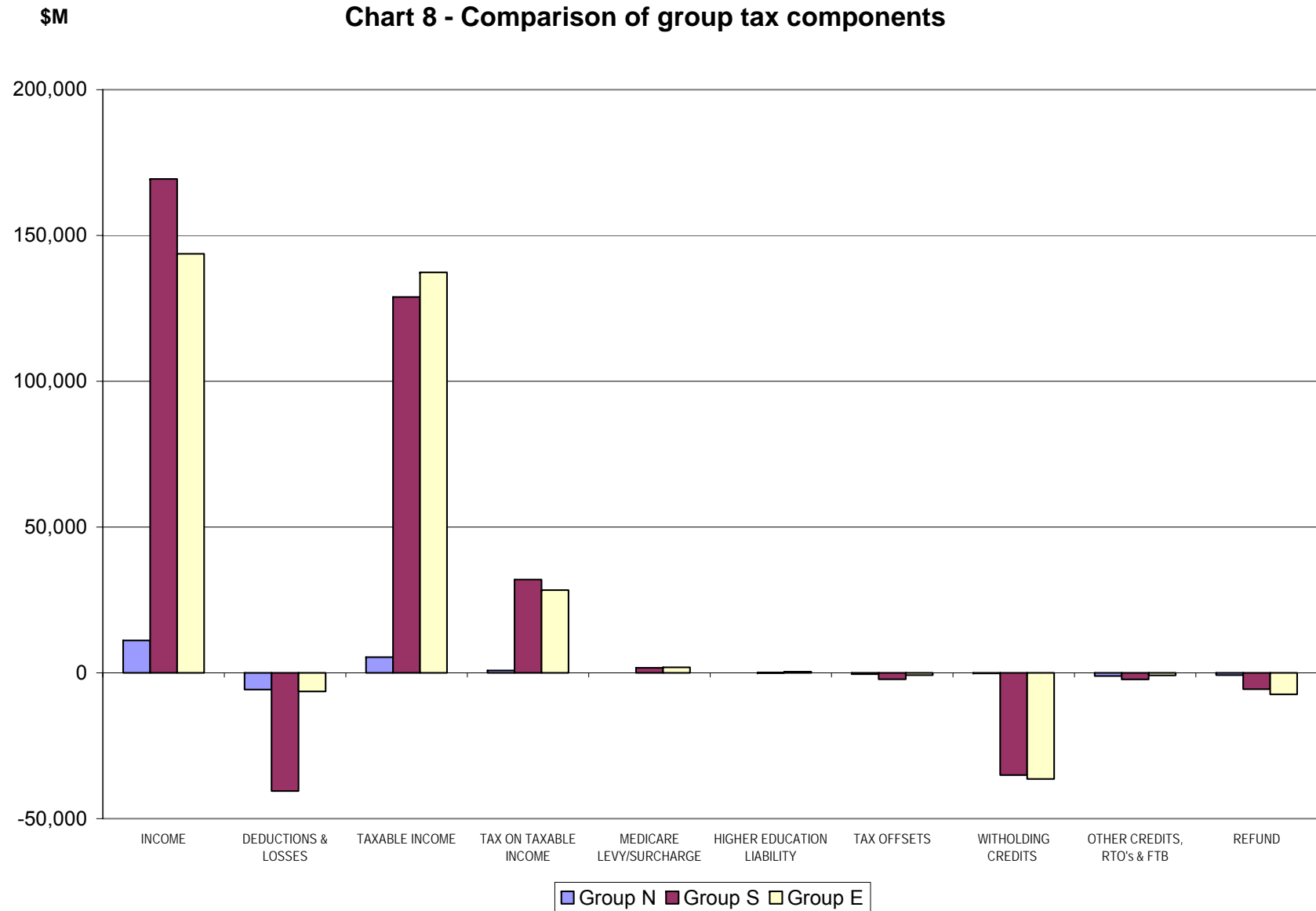
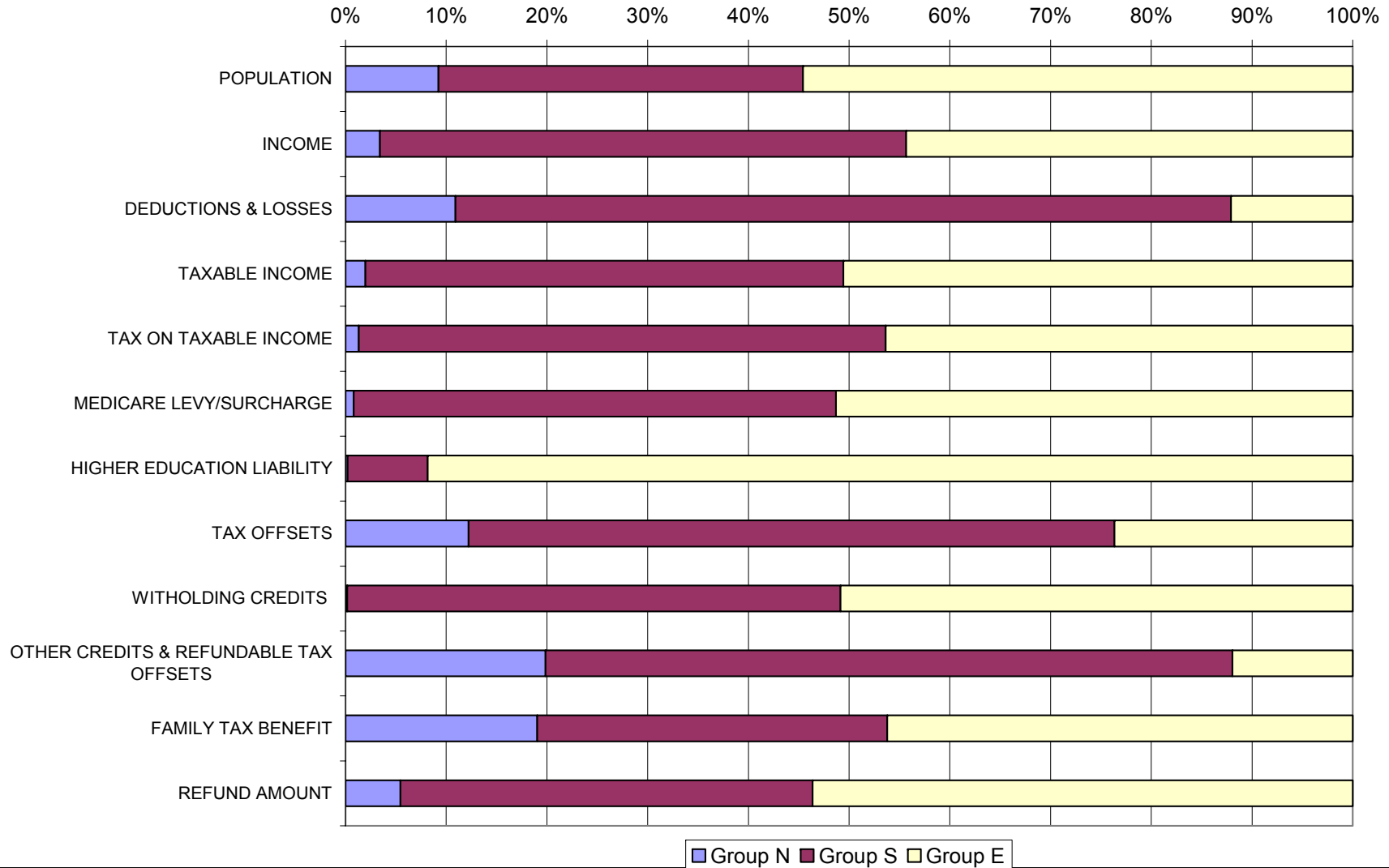


Chart 9 - Percentage comparison of group tax components



ATTACHMENT 5: PERSONAL INCOME TAX RESEARCH REPORT

A RESEARCH REPORT

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Simplifying Personal Income Tax Project, ATO

Project No: 016
June 2000

SIMPLIFYING PERSONAL INCOME TAX:

**A REPORT ON FORTY COMMUNITY
CONSULTATIONS**

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6 PERCEPTIONS OF THE CURRENT SYSTEM

6.1 SYSTEM KNOWLEDGE

The vast majority of research participants knew how the current PAYE taxation system works. Community consultation participants described the PAYE process as consisting of employers regularly deducting tax from the pay of individuals and sending this deduction to the government. They also added that at the end of the financial year they have to lodge their return and maybe receive a refund or a bill from the tax office.

Your employer will deduct a certain percentage of money from your pay for government tax. Tax is used to provide services to the community: social services, pensions, government instrumentalities. At end of the year you provide government with return showing all your income & expenses, so that correct amount of tax is paid. Sometimes too much tax is paid and government issues a refund.

When you are paid your employer takes out a percentage for tax. This is on a sliding scale based on the amount your earn. The tax is used to build schools, hospitals, roads, run the country, etc. At the end of each financial year, you put in a tax return & if possible claim some of the tax back in rebates or expenses.

When you get paid there will be a certain amount taken out as Australian Government Tax which the Government uses to provide services back to the people. Your pay slip will show your Gross Pay, tax amount and then the Net Pay which is the amount you actually receive. People are taxed in accordance with how much gross pay they earn. The higher your gross pay the higher your tax will be. If you have any allowable costs as authorised by the Government in earning your tax these will be listed when you annually lodge your taxation return for the year. This may result in a refund to you or if you have not paid sufficient tax in accordance with your return you may have to pay further tax.

Firstly you get a Tax File Number which is then provided to the employer. The employer deducts tax from income each pay day and sends this to the ATO. The amount is determined by the Government. At the end of the financial year, the employer gives the employee a record of income and tax paid which the employee should take to a Tax Agent/Accountant together with a record of deductions and receipts where applicable. The Tax Agent or Accountant will then do a tax return for employee and send off to the ATO and employee will then be notified whether to pay more tax or receive a refund.

Taxpayers were able to provide a good summary, across the groups, of most of the elements of the current tax system, including: weekly deductions by employers, TFN (without which you end up paying higher taxes), filling in the “employer form” when you start work, group certificates, Medicare levy, superannuation levies, deductions for the use of tax agents, some special issues surrounding areas like education (migrants continue to pay higher rate of HECS until they get citizenship), *TaxPack* to help people fill in a return, keeping all dockets and other supporting documentation, tax free threshold (everyone, even those who claimed to not have much knowledge of the system, were aware of the fact that very low income earners were not subject to tax).

The research showed that, regardless of age, taxpayers have a very good general knowledge of how the taxation system works ... but that they in fact lack confidence in this knowledge.

Even though the majority of research participants knew how the PAYE system worked, there was considerable ignorance on a number of other related taxation issues. For example, very few people knew what a tax rebate was let alone which ones they were entitled to or even receiving. Confusion between rebates and deductions was rife. In fact, a great deal of confusion was apparent when it came to the language of taxation: rebates, (allowable) deductions, withholding, TFN, returns, lodgment, etc. Given the infrequent nature of their contact with the tax system, the technical and sometimes illogical nature of the terms used in taxation make it difficult to learn the meaning of the terms and therefore to feel confident about one's knowledge of an understanding of the system. In a very real sense, the language of tax makes the system complex and sometimes impenetrable for ordinary PAYE taxpayers.

With regard to rebates, awareness was very low and confused. People were largely unaware of most rebates and, as stated above, tended to confuse these with deductions. Even the Private Health Insurance rebate, which enjoyed much exposure via DHAC advertising at the time, was seldom mentioned. The "dependent spouse" rebate also showed very patchy awareness. The Savings rebate was hardly mentioned. Given the paltry level of awareness of rebates available, and of those actually being received by taxpayers, it is a clear conclusion from both rounds of research that income redistribution via lower tax (i.e. rebates) earns no long-term kudos for the government. People notice the rebate's first impact on their pay packet but soon afterward forget they are receiving the financial support from government. As contact with government on the issue of such income support usually only takes place when change occurs, reminders of continued government support seldom take place, may actively only involve one member of the household and are less likely to occur in families and households where incomes are steady or low and changes in circumstances are rare.

Even when rebates are taken as one-off claims at the end of the financial year, our research shows that very few taxpayers are aware either that they claimed the entitlement, what it was for or how much they actually received.

When it comes to deductions, however, awareness is quite high. These are invariably defined as "*work related expenses*." Taxpayers know broadly, what deductions are, but even then confuse these with rebates, often using the terms interchangeably. Furthermore, **the single most significant concern taxpayers have with the current tax system is not feeling confident that they have deducted all the work related expenses that they could have, thereby minimising their tax and maximising their refund cheque.** Whilst they in fact appeared to us to have a very good grasp of their entitlements for deductions, they simply did not feel confident they were getting all they could. Stories about tax professionals finding deductions they had never dreamt of were popular as was the experience of two co-workers getting different refunds because one was going to a tax professional and the other was not. One participant had a story about the way his accountant had "found" almost \$1000 of allowable deductions where he, working on his own with the *TaxPack*, had sourced only \$250. This fact was referred to later in the discussion in the recurring debate between simplicity and fairness. Indeed, it is missing out on this kind of "fair" return that worries people about the introduction of "simpler" systems.

In Stage 1 consultations, taxpayers constantly mentioned the goods and services tax (GST). People aired quite cynical comments about the introduction of the GST. It was clear that they were significantly ignorant about the issues associated with GST (as at February 2000 when

the first stage of research was conducted.) Although this research did not focus on the GST, there was clear evidence in the discussions that people were not aware of the tax cuts and new tax scales coming in on July 1st with the GST reforms. By Stage 3 awareness of impending tax cuts was slightly higher but the cynicism remained (“*You’ll see, they’ll come up for some reason for not giving it to us*”).

Generally, young people were significantly less aware than older people of issues related to the tax system. They did not know a great deal about deductions, rebates or the GST. Their relatively limited experience with the tax system was reflected in the low level of knowledge they displayed. It was clear that education about allowable deductions was sorely needed, especially for this segment of taxpayers. That said, the level of broad experience people had with economic and financial matters influenced how much they knew about the current tax system. For example, some younger research participants had a range of investments. Consequently, they were quite sophisticated in tax issues. Furthermore, young people who had parents who involved them in their tax matters were also very knowledgeable about the tax system.

The research indicated that people who use tax agents or accountants tend to rely on the advice of these tax professionals almost exclusively. Non-self-preparers see tax agents and accountants as their partners or allies in dealing with the ATO. In fact, it was clear that people who use tax professionals trusted them completely. They would never think about contacting the ATO directly to obtain information or seek a clarification. Certainly their agents do not make such suggestions and always seek to act as “middlemen” in any such communications.

A number of issues related to the current system were specific to **rural areas**. People living in rural areas complained about the ATO closing local offices and emphasised that they needed face-to-face contact if they have a query, especially if complex issues needed to be discussed. Research participants emphasised that they were often unhappy and frustrated with having to join phone queues. (In this context, however, Centrelink and Telstra were both mentioned as providing worse telephone service than the ATO.) These issues were especially prominent in non-metropolitan areas such as Toowoomba where the local ATO office had been closed down. The experience of rural taxpayers was that using the telephone for tax queries leads to frustration and often incorrect or inconsistent advice.

With regard to other service models, the research showed two clear trends:

- ❖ Increasing appreciation of **Tax Help** as a service for low income people
- ❖ Increasing popularity of **Internet and e-mail** options for financial transactions.

People in rural areas appeared to be a lot more aware of *Tax Help* and were more welcoming of this type of assistance. People in metropolitan areas were more likely to call for a service like *Tax Help*, not likely to know about it or not call it by its name, but describing its features in some detail and expressing a need for such a service.

In much unprompted discussion, taxpayers also expressed their increasing comfort with e-commerce and transacting their financial affairs over the Internet. There was a very strong call, especially from people aged under 35, for more of the information and data exchange with the ATO to occur through this new more interactive and customer-focused medium than via traditional paper-based methods.

6.2 TAX RETURNS

Most taxpayers did not look forward to Tax Time ... unless they were entitled to a sizeable refund cheque. As a way of dealing with this, they had turned over much of the paperwork and worry to their tax professional. Even a segment of the participants who still did their own returns were thinking of paying an accountant to do the work for them in the future. Most felt that the tax return process “works alright” because they had effectively paid their way out of the complications and the paperwork, needing only to ensure that they kept their receipts throughout the year.

However, as income sources diversified and fluctuated (investments, other sources of income, part-time and changing work arrangements etc.) the tax return process became more complex. Much of the complexity derived from working through eligible deductions and making sure you had claimed everything you could. Most people felt the *TaxPack* did not help in this regard.

The most vehement complaints about the current return came from older people who fondly recall using a double-sided sheet “in the good old days.” They felt that the system was getting increasingly complex and that they thus have to use tax professionals.

It's just paperwork you've got to do once a year.

It's a game, you learn the rules, find the loopholes and play their game.

Re-write the tax return to be understood more easily and less complex or the government tax agents to do it free of charge even though we will be taxed on it anyway.

Simplify tax return process for 'simple' returns, i.e. single employer minimum deductions, minimum additional income. Cut out the legalese. Make instructions easier to understand.

Four page tax return in use years ago was much simpler and easier to understand. It dealt with most areas applicable to the majority of taxpayers.

For many people the tax booklets are too complicated. Questions – many of them – sound like gobble-de-gook. The old system where one had to fill in a double page form was less complicated, especially for those who are older or people not born in Australia. Words used should be in as plain a way to explain the form as possible. In other words, don't use 'government speak'.

Years ago we had a much simpler tax form to fill out, why can't we go back to the old ways? Also I am talking about people that see the size of the Tax Pack and that alone scares them into going to a tax agent.

I think they could have made the forms easier to understand and if they can't do that they should have an office where you can go to get help without it costing you.

Tax pack explanations become confusing as they endeavour to cover the numerous aspects encountered by taxpayers. Instead the K.I.S.S. principle should be followed and answers to specific questions or circumstances should be more readily available from the ATO.

I believe that the information provided in the tax pack is very broad, almost ensuring that accountants keep busy due to people often being reluctant to fill in their own tax returns.

Tax forms are too complicated. Costs some people too much money to use a tax agent.

These taxpayers, like most others, show little recognition of the role of increasing complexity in their tax affairs in escalating their need for professional assistance. Most cases where people complained about the increasing system complexity also clearly showed that in part their own tax affairs and other financial dealings had become more complex.

Instead of recognising this, people tend to resent needing to use accountants for something that they feel should be simple ... i.e. a tax return. Numerous comments were made to the effect that "I'm university educated ... I think I'm pretty smart most of the time, but when I see tax return I just lose all my confidence that I can understand it." Taxpayers also resent the "fact" that using tax professionals to do one's return means it is less likely to be checked by the ATO and that people can have more time to put the return in. Another theme of complaint which people returned to repeatedly was the sense that the system was being deliberately complexified [their word] to put people off claiming so much.

Finally, the process of completing tax returns is taken very seriously by Australian taxpayers . This is an annual financial transaction a lot of taxpayers pore over and check again and again.

They take a lot of care over it because it is their one chance to recoup from a system that regularly takes money out of their pocket, as they see it. Whilst they feel it should be simple, they take it very seriously and wish they understood it more and felt more in command of what they were doing when filling it in. (Consequently, most taxpayers cannot now imagine doing something so important in a telephone call, as will be outlined later in reactions to the tele-filing proposal.)

Overall, people do dread the tax return process if they expect a debit and look forward to it if they expect a refund. In either case, they dread ...

- ❖ the paperwork,
- ❖ complex questions and
- ❖ complex wording of the explanations.

For young people in particular, the complexity of the return system is due to a number of factors:

- ❖ Multiple income sources (part-time jobs, income support)
- ❖ Multiple jobs
- ❖ Keeping track of group certificates
- ❖ Mobility (change of address)
- ❖ Interlocking government systems (i.e. Centrelink and ATO issues)
- ❖ HECS issues
- ❖ Varying deductions (for study, work etc.)

A constant theme for young people was therefore the complexity that arises from a series of transitions they often experience – work to study (or the other way around), periods of no employment, part-time employment, mixed part-time jobs and study. It is the changes, and the resulting mixed situations they face, that drive some of the daunting complexity.

6.3 REFUNDS

Refunds are what the personal tax system is all about for most taxpayers. Maximising one's deductions is the only thing that makes the system "work" for ordinary PAYEs because this is the way they get to maximise their refund. Certainly, a personal income tax system without refunds would be unpopular. Individual taxpayers are keen to preserve access to refunds because it helps them to preserve a sense of control and a feeling that they at least have a chance to get their "fair share back" in the form of a refund.

Most taxpayers with whom we spoke expected a small refund. The community generally felt this "forced saving" in the form of a refund was a good thing, most feeling that it is handy to have some money saved through taxation (*"It's a bit extra you don't necessarily bank on"*). A minority said that, in theory, they preferred that they held the money and made use of it throughout the year rather than leaving it with the ATO.

In most households, the refund is used to pay current bills: *"Whatever's on the fridge," "Minor start on the next Bankcard bill."* Some use it for a "splurge" or a special treat. However, for most taxpayers, it is not a major aspect of yearly finances. They do not rely on it as a major cash-

flow injection. There is a strong feeling, though, that this is a recent development. Older taxpayers in particular recalled larger refunds were the norm and that these were relied on quite heavily and use for major purchases such as whitegoods. This is related with their feeling that the level of allowable deductions has declined over the years. They are expecting and getting less nowadays, in the form of deductions and consequently in refunds.

Refunds were therefore almost like a forced savings account, useful for buying special one-off items. For students, the refund was put towards new books and other study expenses whilst for those with relatively simple and predictable tax arrangements – eg those who always get the sole parent rebate – planning their finances did include an expectation of the refund cheque.

In most groups, there was a strong feeling that claiming deductions is what the tax return process is all about (because it maximises the refund cheque) and making sure you got access to the ones you are entitled to is the reason for investing the time, effort and research needed to complete a return. Most participants therefore looked forward to tax time because they expected either a small or a large refund.

Some experience with electronic refunds was apparent and those who experienced it were comfortable with that approach. Users of direct credit preferred the simplicity, lack of a middleman and the convenience. However, when other taxpayers were made aware of the direct credit facility, most dismissed it out of hand. People get great satisfaction from a tax cheque in the hand. The cheque is tangible proof of a return on all the work they have put in to eke out a refund, all the receipts they have had to keep and claim. Most taxpayers, even the young, like to see the cheque that they have received as a refund and to show that their efforts have paid off. There was a strong residual instinct to get the cheque and do the banking personally to see that it has really happened.

The feeling was that the Internet and other forms of e-banking would be the way of the future, but that there would always be a residual need for more “manual” systems for some people. In fact, across all age ranges, taxpayers felt they needed to see the ATO cheque because they had earned it. Holding a real cheque in your hand was the real “pay off” for such efforts in a way that an electronic transaction could never be.

6.4 DEBITS

Few of the participants in the community consultations had personal experience of having to meet a tax debt. There was some (low level) awareness of the ability to spread a tax debt out over several repayments and the ability to balance it out against later years. These options were accepted as a positive but, not surprisingly, did not attract a lot of praise (i.e. people are much happier complaining about the things they do not like in the tax system and the ATO than they are praising or recognizing the good elements). Against that were stories about the ATO being harsh and punitive in collecting or demanding tax debts. A story was mentioned of a small businessman with a \$30,000 tax debt whose immediate payment demand, from which he could not get any relief, sent him broke (*“what’s the point of that – they don’t get their money anyway and he’s out of business?”*).

Taxpayers also knew one could arrange instalment payments for tax debts, although one participant claimed the ATO had “demanded” a \$4000 debt to be paid within 15 days but his accountant had negotiated a “deal” to allow him to pay it off over time. (This same participant was dogmatic in his explanation that, as a TAFE teacher, he could claim the cost of a new edition of a textbook only to the extent that it had new chapters. So, if only three chapters had been changed, he could only claim three chapters worth of expenses in that year.)

There was very low awareness of the direct debit system for paying tax debits. When told of this option, the majority reaction was suspicion and cynicism. People were very hesitant to leave “an open chequebook” for the ATO to draw on their funds without their explicit say so. There is a fear of errors and that the ATO will draw funds when they are not in a position to pay the debt or that the ATO will take out too much or do so too early. Most simply did not think that they would receive early notification from the ATO in order to arrange their finances in time and simply assumed that using the facility would provide the ATO with *carte blanche* access to their money.

Whilst people are happy to let other creditors draw on their funds, the feeling is that the ATO is a government body (hence prone to errors) and omnipotent ... hence getting one's money back once an error is made would be very difficult.

Even younger people, usually welcoming of electronic transactions, were not responsive to this idea. There is a basic lack of trust in the ATO when it comes to this issue and also a strong need to remain in control of one's finances when a significant financial transaction such as a tax debt is involved. Furthermore, the fact that they assumed the ATO could (or even would) draw on their money without first advising them (via an assessment notice) as to the size and timing of such a withdrawal, indicates that mistrust of the ATO is deeply ingrained in the psyche of Australians. There was real lack of trust in the ATO on this issue. It could not be trusted with full access to their money because, by either accident or design, the ATO could end up taking out too much money or take it out too early.

6.5 DEDUCTIONS

With regard to deductions, there was generally good awareness of what taxpayers could and could not claim in the form of allowable deductions. Taxpayers were readily able to list off deductions and determine if they were allowable for their occupation. **However, a foremost concern in their minds is that they are unsure they are getting all the deductions to which they are entitled.** This is the chief grey area in the system that they constantly worry about because this is where they get their “fair share.” If they feel they do not know all the allowable deductions, the system is perceived as being unfair toward them. If they feel this strongly enough, they will consider using a tax professional who is perceived as knowing more about “these things” and will help to get their fair share of deductions.

The taxpayers with whom we spoke exhibited a low level of understanding about how deductions actually impacted on their refund. Time and again, one was left with the impression that taxpayers assumed a dollar claimed in deductions was another dollar added to their refund cheque. There was only low-level understanding that deductions reduce taxable income rather than reducing the tax bill dollar for dollar.

The feeling that the ATO does not educate taxpayers about deductions because it wants to minimise claims was also very popular. The view was often expressed that if the ATO were interested in fairness, it would ensure that all taxpayers received all their deductions. The first step toward this would be a more direct attempt to educate taxpayers about their entitlements to deductions. As yet, taxpayers see very little evidence of ATO's involvement in this regard. There was low-level awareness that the *TaxPack* contained such information. Most taxpayers were unaware of this and called instead for direct education via their employers or unions so that they would know exactly which deductions were allowed in their occupation.

Overall, deductions are perceived as making the system fairer because they allow individual taxpayers to access allowable claims for legitimate expenses and those who spend a lot in earning their income can in turn claim a lot. Yet, it is deductions that make the tax system complex and make simplification harder. Taxpayers recognise this. However, very few people in the community consultation process took the next step of suggesting that deductions should be reduced or completely abolished. This was largely tied to their view that deductions allow them to make the system fairer ... toward themselves.

Finally, in most community consultations, there was a view that the “bar” on deductions was being deliberately raised to ever more difficult heights so that people could claim less and less each year: *“You always used to look forward to a refund every year, but not now...all the deductions have been taken away.”* There was also general recognition that this trend for making access to deductions harder has resulted over time in increased complexity of the tax system, as systems and laws had to become more complex in determining which deductions were allowable and which not.

ATTACHMENT 6: PUBLIC RULINGS PANEL EXTERNAL EXPERTS

PUBLIC RULINGS PANEL FROM AUGUST 2006 – INCORPORATING INTERNATIONAL ISSUES

The Public Rulings Panel meetings now discuss a 'mixture' of income tax and international tax matters under the Chairmanship of Des Maloney, Deputy Chief Tax Counsel. This approach gives greater flexibility and provides continuity in the management and development of public rulings on both income and international tax matters. The Chairman is supported by other Deputy Chief Tax Counsels at and between panel meetings. The external members of the Public Rulings panel are:

Kevin Burges
Ray Conwell
Kevin Pose
Richard Shaddick
David Williams
Prof. Robert Deutsch
Prof. Rick Krever
Prof. Richard Vann (unavailable for 2006 calendar year due to other commitments)

PREVIOUS PUBLIC RULINGS PANELS

January-August 2006

Prior to August 2006, the Public Rulings panel consisted of:

Peter Walmsley (Chair)	Deputy Chief Tax Counsel, Tax Office
Des Maloney	Deputy Chief Tax Counsel, Tax Office
Kevin Burges	External Consultant
Ray Conwell	External Consultant
Kevin Pose	External Consultant

Pre-January 2006

Prior to January 2006, the Public Rulings panel consisted of:

Michael D'Ascenzo (Chair)	Chief Tax Counsel, Tax Office
Peter Walmsley	Deputy Chief Tax Counsel, Tax Office
Des Maloney	Deputy Chief Tax Counsel, Tax Office
Kevin Burges	External Consultant
Ray Conwell	External Consultant
Kevin Pose	External Consultant
Tom Magney	External Consultant
Ian Phillips	External Consultant
Prof. Robert Deutsch	External consultant

PREVIOUS INTERNATIONAL RULINGS PANELS

January-August 2006

Prior to August 2006, the International Rulings panel consisted of:

Des Maloney (Chair)	Deputy Chief Tax Counsel, Tax Office
Peter Walmsley	Deputy Chief Tax Counsel, Tax Office
Jim Killaly	First Assistant Commissioner, Tax Office
Ken Allen	Assistant Commissioner, Tax Office
Richard Shaddick	External consultant
Prof. Robert Deutsch	External consultant
Prof. Rick Krever	External consultant
David Williams	External consultant
Prof. Roger Layton	External Consultant
Prof. Richard Vann	External consultant (unavailable during 2006 calendar year due to other commitments)

Pre-January 2006

Prior to January 2006, the International Rulings panel consisted of:

Michael D'Ascenzo (Chair)	Chief Tax Counsel, Tax Office
Des Maloney	Deputy Chief Tax Counsel, Tax Office
Peter Walmsley	Deputy Chief Tax Counsel, Tax Office
Prof. Richard Vann	External consultant
Richard Shaddick	External consultant
Prof. Robert Deutsch	External consultant
Prof. Roger Layton	External consultant
Prof. Rick Krever	External consultant
Kevin Burges	External Consultant

ATTACHMENT 7

ATTACHMENT 7: NUMBER OF PUBLIC RULINGS ISSUED BY TYPE SINCE 1995

FINAL PUBLIC RULINGS

Income year	TRs	TDs	GSTRs	GSTDs	PRs	CRs	GSTB	EB	SCR	SCD	SGD	SGR	SD	MT	WETR	FGRR	LCTR	PGBR	Total
2006	18	66	11	6	134	91	0	0	23	1	3	1	0	0	0	0	0	2	356
2005	21	96	7	5	138	131	0	0	16	5	1	1	1	2	1	0	1	1	427
2004	20	38	11	4	112	102	0	0	29	5	7	0	0	0	0	0	0	0	328
2003	13	33	14	5	91	53	2		51	4	1	0	0	0	2	1	1	0	271
2002	25	21	6	2	160	90	1	0	0	4	1	0	0	0	0	0	0	0	310
2001	10	40	10	7	154	25	4	1	0	4	1	0	0	1	0	0	0	0	257
2000	24	78	32	0	103	0	4	0	0	6	0	0	0	0	0	0	0	0	247
1999	23	50	0	0	93	0	0	0	0	4	0	0	0	0	0	0	0	0	170
1998	22	22	0	0	0	0	0	0	0	10	0	0	0	0	0	0	0	0	54
1997	21	29	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	50
1996	32	64	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	96
1995	33	71	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	104

Product Rulings - PRs, Class Rulings - CR, Goods & Services Tax Rulings - GSTRs, Goods & Services Tax Determinations - GSTDs, Goods & Services Bulletins - GSTB, Excise Bulletins - EB, Taxation Rulings - TRs, Taxation Determination - TDs, Superannuation Contribution Determination - SCDs, Superannuation Guarantee Determination - SGDs, Miscellaneous Taxation Rulings - MTs, Fuel Grant Rebate Ruling - FGRR, Luxury Car Tax Ruling - LCTR, Product Grant & Benefits Ruling - PGBR.

UNCLASSIFIED

ATTACHMENT 7

DRAFT PUBLIC RULINGS

Income year	TRs	TDs	GSTRs	GSTDs	PRs	CRs	GSTB	EB	SCR	SCD	SGD	SGR	SD	MT	WETR	FGRR	LCTR	PGBR	Total
2006	16	68	11	0	0	0	0	0	0	0	1	0	0	1	0	0	0	0	97
2005	30	90	3	7	0	0	0	0	0	0	0	2	1	2	0	0	0	1	136
2004	11	32	8	4	0	0	0	0	0	0	0	0	0	0	0	0	0	0	55
2003	10	21	13	4	0	0	0	0	0	0	0	0	0	0	0	0	0	0	48
2002	16	17	6	3	0	0	0	0	0	0	0	0	0	0	0	0	0	0	42
2001	14	19	9	3	0	0	0	0	0	0	0	0	0	0	0	0	0	0	45
2000	15	83	33	3	0	0	0	0	0	0	0	0	0	0	0	0	0	0	134
1999	36	43	0	0	0	0	0	0	1	0	0	0	0	0	0	0	0	0	80
1998	23	10	0	0	0	0	0	0	1	0	0	0	0	0	0	0	0	0	34
1997	12	17	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	29
1996	30	27	0	0	0	0	0	0	0	0	1	0	0	0	0	0	0	0	58
1995	31	51	0	0	0	0	0	0	0	0	2	0	0	0	0	0	0	0	84

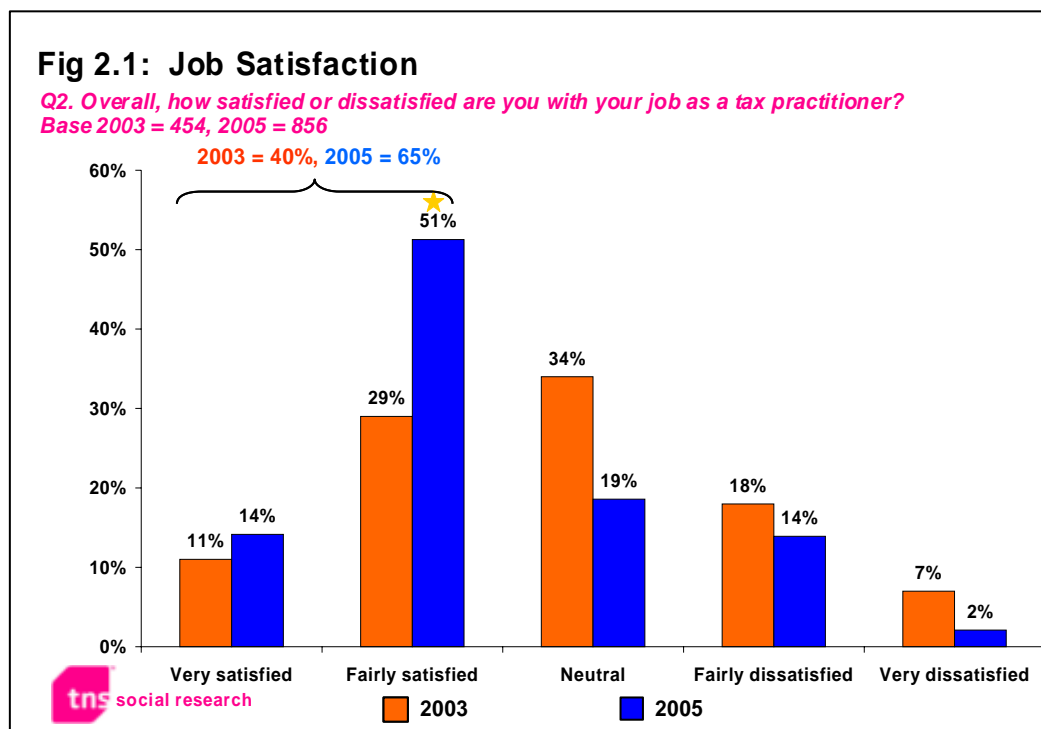
Product Rulings - PRs, Class Rulings - CR, Goods & Services Tax Rulings - GSTRs, Goods & Services Tax Determinations - GSTDs, Goods & Services Bulletins - GSTB, Excise Bulletins - EB, Taxation Rulings - TRs, Taxation Determination - TDs, Superannuation Contribution Determination - SCDs, Superannuation Guarantee Determination - SGDs, Miscellaneous Taxation Rulings - MTs, Fuel Grant Rebate Ruling - FGRR, Luxury Car Tax Ruling - LCTR, Product Grant & Benefits Ruling - PGBR.

UNCLASSIFIED

ATTACHMENT 8: RESEARCH RESULTS EXTRACTED FROM “UNDERSTANDING TAX PRACTITIONERS”

SATISFACTION WITH JOB

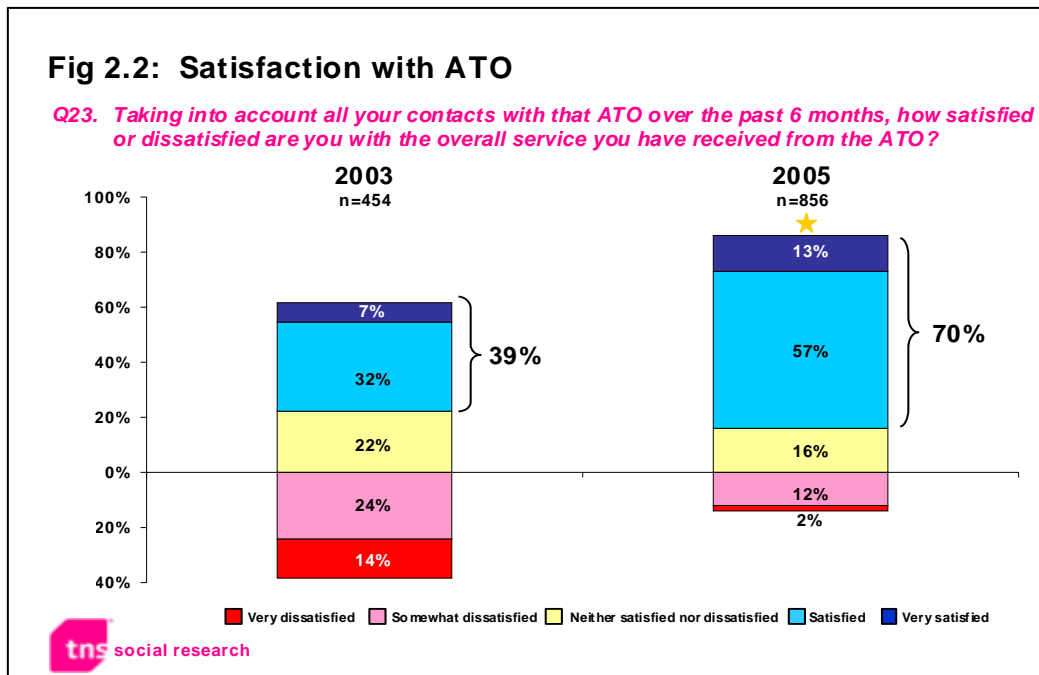
Overall, the proportion of tax agents saying they were satisfied with their job increased markedly since 2003 (from 40% to 65%), and the proportion who were dissatisfied reduced from 25% to 16%.



SATISFACTION WITH TAX OFFICE SERVICE

These results show a dramatic improvement in attitudes towards the ATO since 2003.

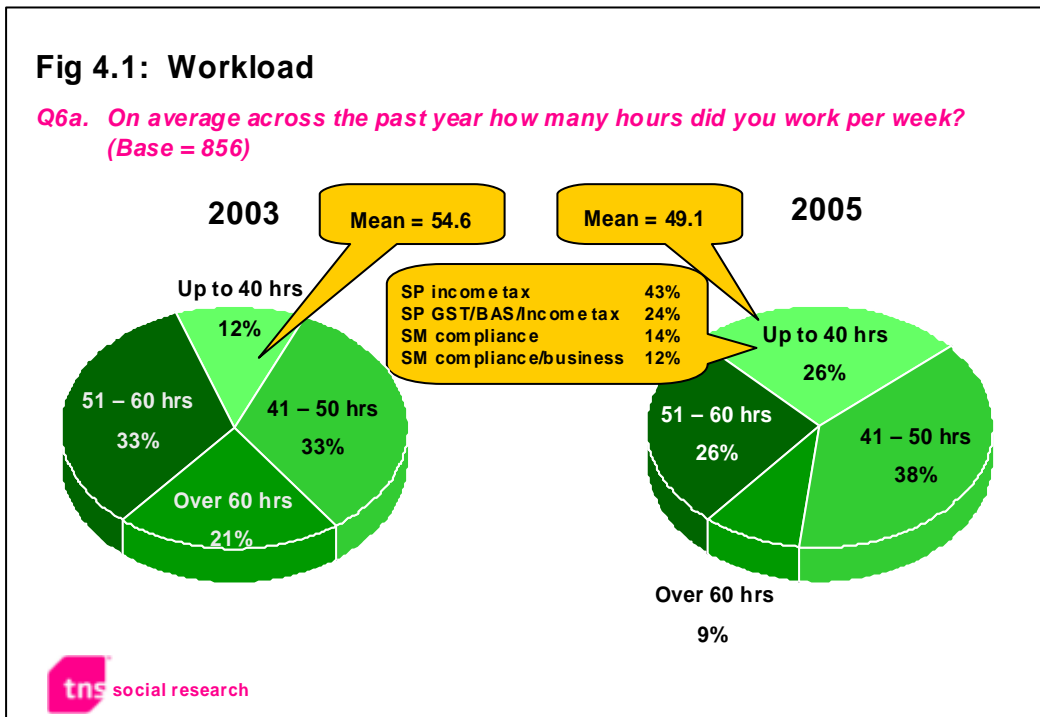
- the proportion of agents satisfied with the ATO's service has increased from 39% to 70%
- perhaps more notably, the level of dissatisfaction has dropped from 38% to 14%
- thus in 2003, the numbers of satisfied and dissatisfied agents were about equal; in 2005 the 'satisfieds' outnumber the 'dissatisfieds' 5:1



WEEKLY WORKING HOURS

It is clear from these results that there has been a substantial decrease in weekly working hours since 2003. The average working week for tax agents has reduced from 54.6 hours in 2003 to 49.1 hours in 2005. The proportion of tax agents working more than 50 hours per week has declined from 54% to 35%.

It is interesting to note that one segment – i.e. sole practitioners who focus on income tax services – is working considerably fewer hours than the rest of the industry. Just under half of these sole practitioners (43%) are working less than 40 hours per week, reflecting the lifestyle choice (and perhaps stage in the work cycle) of this particular segment of the industry



PERCEIVED WORKLOAD

Not surprisingly, given the reduction in absolute working hours, fewer tax agents view their workload as excessive these days. Most notably, there has been a substantial increase in the proportion of agents who feel their workload is 'about right' – from only 22% in 2003 to 38% in 2005.

Fig 4.2: Workload

Q6b. How do you feel about the number of hours you work? Do you feel it is...? (Base = 856)



ATTACHMENT 9: 2006 MASTER TAX GUIDE EXTRACT

32 TAX AGENTS

[32-130] Liability of tax agents**Negligence**

A registered tax agent is obliged to reimburse a taxpayer who becomes liable to pay a fine, penalty, additional tax, GIC or shortfall interest charge as a result of the agent's negligence (ITAA36 s 251M). The taxpayer is not, however, exonerated from liability (*Case 5/2006*, 2006 ATC 137).

Tax agents may be sued at common law for breach of contract or negligence. However, taxpayers cannot recover under both s 251M and common law. Where the amount awarded under s 251M exceeds the damages assessed under a negligence claim, the s 251M amount is awarded (*Pech v Tilgals* 94 ATC 4206). See also *Sacca v Adam* 83 ATC 4326 (31-015) and *Markham v Lunt* 84 ATC 4010 (24-070).

Examples of cases where taxpayers have been successful against their tax agents include:

- an accountant (also a de-registered tax agent) who breached his fiduciary duty when he used his client's tax money for his own purposes (*Stambulich v Ekamper* 98 ATC 5160)
- a firm of accountants who failed to carry out clients' instructions relating to the distribution of shares on the winding up of a company (*Jindi (Nominees) v Dutney* 93 ATC 4598)
- a chartered accountant/tax agent who failed to advise his client on the introduction and effect of the thin capitalisation provisions that impacted on the advice he had given (*Bell v Vahexi Pty Ltd* 99 ATC 4055).

Accountants responsible for the preparation of a taxpayer's return cannot necessarily rely on the accuracy of the information provided by the taxpayer (*Walker v Hungerfords* 88 ATC 4920).

In general, liability for negligent advice is limited to the area in which the tax agent holds himself/herself out as being competent (*Mohr v Cleaver* (1985) Aust Torts Reports ¶¶80-720). The mere fact that an accountant advised a taxpayer to enter into a tax scheme, which the Commissioner much later rejected as a sham, did not prove that the accountant had been negligent (*Doug Sim Enterprises v Patrick Wan* 88 ATC 4078). However, tax advisers will fail in their duty if they do not take reasonable steps to ensure that a client understands the risks involved in a particular tax plan (*EVBj v Greenwood* 88 ATC 4977).

To successfully sue for damages, a taxpayer must prove that the agent's negligence caused it loss. For example, the disallowance of a claim for the pre-purchase of trading stock did not cause the taxpayer any loss in *Tip Top Dry Cleaners* 98 ATC 4346. In addition: (i) the transaction that the taxpayer entered into was not the transaction that the agent had advised on; (ii) the taxpayer decided to enter into that transaction after receiving advice that, if it proceeded with the purchase and claimed a deduction, it would not be able to sustain the deduction if it were disallowed; and (iii) the agent explained the alternatives to the taxpayer and the consequences of each alternative. This meant that the agent had discharged the duty of care and, accordingly, the claim of negligence was unsuccessful.

Under the penalty tax regime, a taxpayer is liable to penalties for understatements of tax caused by the culpable conduct of a tax agent in dealing with the taxpayer's affairs where the agent has failed

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to take reasonable care, behaved recklessly or intentionally disregarded the provisions of the legislation (29-700). A taxpayer's recourse in these circumstances is to sue the agent for recovery of the penalty under s 251M.

Other offences

A registered agent (or exempt agent) commits an offence if he/she allows unauthorised persons to carry out the agent's work, i.e. if anyone other than an employee, a registered tax agent or a partner is allowed to prepare tax returns or objections or conduct business on the agent's behalf (ITAA36 s 251N). Furthermore, any such work must be done under the supervision and control of a registered nominee of the agent (or the agent personally in the case of individual tax agents). These requirements, of course, do not preclude the employment of a solicitor or counsel to provide professional services in those income tax matters for which they are entitled to charge fees (32-000). The nominee's responsibility for supervision is substantial and would not normally be discharged simply by a casual appraisal of completed work (S & T Income Tax Aid Specialists 87 ATC 2001).

Agents may also be liable for offences such as making false or misleading statements, falsifying records, or falsifying or concealing a person's identity or address (29-700). This also applies where the agent aids, abets, conspires or otherwise assists in the commission of any of those offences.

The breach of the in-house assets rule by a superannuation fund was made more serious by the fact that one of the directors of the trustee company was a tax agent (QX971 v APRA 99 ESL 1).

Liability of partners

Where a partnership fails to comply with any of its obligations under the tax agent provisions, each partner is guilty of an offence unless the partner can prove that he or she had no knowledge of the failure. However, only one partner can be punished for one offence (ITAA36 s 251P).

Commissioner's prosecution policy

It is the Commissioner's policy to prosecute a tax agent where the agent has omitted income or inflated claims in a client's return. Where a tax agent gives false or misleading information in an objection, reply to a questionnaire or at an interview with an ATO officer, it is the Commissioner's policy to prosecute the agent where possible. Where the agent has been an accomplice of a taxpayer in furnishing false returns or information, the agent will be charged with the same offence as the taxpayer (*Taxation Ruling IT 2246*).