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The Parliament of the Commonwealth of Australia

# Report on the inquiry into tax deductibility

House of Representatives  
Standing Committee on Economics

June 2017  
Canberra

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## Chair's foreword

The committee's review focussed on enhancing compliance in relation to tax deductions. The committee noted that \$100 million of abuse was identified in a single year by the Australian Taxation Office (ATO), through a review of the Work-Related Expenses (WREs) claims of about one in one thousand taxpayers. The committee sees considerable scope for improvement in this area and has recommended the ATO review its compliance activity in relation to WREs.

The committee's view is that the ATO should remain proactive in identifying areas that are at risk of systemic abuse. Accordingly, the committee recommended that the ATO be instructed to analyse each detailed subcategory of tax deductions and identify areas that it believes are particularly open to systemic abuse and overclaiming. The ATO should then rank these subcategories in order of the size of the financial risk they represent to Government revenue, and recommend amendments to law or policy where appropriate.

The committee also considered options to simplify the personal and company income tax systems, and examined options to broaden the base of these taxes in order to fund reductions in marginal rates. In particular, the committee's review examined the areas of WREs and interest deductibility.

While the committee sees opportunities to improve the operation of the tax system, and has recommended changes to strengthen compliance, the committee supports the ongoing ability of Australians to claim legitimate deductions.

In relation to WREs, the committee saw little rationale for altering existing arrangements that allow Australians to claim personal income tax deductions for valid WREs. WRE deductions represent only 4 per cent of individual and other withholding tax revenue. This means that even the complete abolition of WRE deductions would only cover the cost of a very modest reduction in personal income tax rates.

Figures currently provided by The Treasury show that, in 2014-15, there were \$21.8 billion in WRE deductions claimed, comprising almost two-thirds of total deductions. However, this is not an indicative cost to the Budget of WREs because the amount a person receives is calculated based on their taxable income. It is for this reason that the Parliamentary Budget Office (PBO) was asked to provide the total value of selected income tax deductions and estimates of the revenue forgone from these deductions. While the PBO provided a general estimate of the cost to government revenue of WREs, The Treasury was unable to provide a confirmed figure.

In the committee's view, it is important that the actual cost to government revenue of WREs is clearly understood in order to inform budget planning. It is for this reason that the committee recommends The Treasury provides a clear estimate of the actual cost to Government revenue of WREs so as to properly inform policy in this area.

The committee heard that while significant compliance burdens are associated with Australia's personal income tax system, technological advancements are assisting with simplifying taxpayers' experiences in claiming deductions and lodging their tax returns. The committee has recommended that the ATO continue with this work, which shows promise in utilising technology to streamline tax processes.

In relation to company income tax deductions, the committee saw no evidence for change. The committee recognised the potentially significant negative effects that may result from change to deductibility arrangements, particularly in relation to investment in the Australian economy. As a consequence of this, the committee recommended that current arrangements should be retained.

The committee also noted the significant work currently being undertaken by the Government on the implementation of the G20/OECD Base Erosion and Profit Shifting recommendations. The committee recommended that the Government continue its important work in this area. This will further strengthen Australia's robust rules addressing tax integrity.

David Coleman MP  
Chair



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# Membership of the Committee 44<sup>th</sup> Parliament

|                                       |   |
|---------------------------------------|---|
| Chair                                 | Mr David Coleman MP (from 11 March 2016)                          |
|                                       | Mr Craig Laundry MP (from 13 October 2015 to<br>18 February 2016) |
|                                       | Mr John Alexander OAM MP (to 12 October 2015)                     |
| Deputy Chair                          | The Hon Ed Husic MP   |
| Members                               | Mr John Alexander OAM MP (from 13 October 2015)                   |
|                                       | Mr Scott Buchholz MP  |
|                                       | Dr Jim Chalmers MP (to 19 October 2015)                           |
|                                       | Mr Pat Conroy MP  |
|                                       | Dr Peter Hendy MP (to 12 October 2015)                            |
|                                       | Mr Kevin Hogan MP   |
|                                       | Mr Craig Kelly MP   |
|                                       | Mr Craig Laundry MP (to 24 February 2016)                         |
|                                       | Ms Clare O'Neil MP (from 19 October 2015)                         |
|                                       | Mr Clive Palmer MP  |
| Ms Fiona Scott MP (from 2 March 2016) |   |
| Supplementary<br>Member               | Mr Andrew Giles MP  |



# Membership of the Committee 45<sup>th</sup> Parliament

|              |   |
|--------------|---|
| Chair        | Mr David Coleman MP   |
| Deputy Chair | The Hon Matt Thistlethwaite MP  |
| Members      | Mr Adam Bandt MP<br>Ms Julia Banks MP<br>Mr Scott Buchholz MP<br>Mr Trevor Evans MP<br>Mr Kevin Hogan MP<br>Mr Craig Kelly MP<br>Mr Matt Keogh MP<br>Ms Madeleine King MP |

## Committee Secretariat

|                     |  |
|---------------------|--|
| Secretary           | Mr Stephen Boyd  |
| Inquiry Secretaries | Dr John White (from 20 March 2017)<br>Ms Samantha Mannette (until 17 March 2017) |
| Researcher          | Ms Marina Katic  |
| Technical Advisor   | Ms Winchin Yung  |
| Office Manager      | Ms Jazmine Rakic   |



## Terms of reference

On Tuesday 1 December 2015 the Treasurer, the Hon Scott Morrison MP, asked the Committee to undertake an inquiry into the simplification of the personal and company income tax system.

### **Terms of reference**

The Committee will examine some options to simplify the personal and company income tax system, with a particular focus on options to broaden the base of these taxes in order to fund reductions in marginal rates. Matters to be examined include:

- The personal tax system as it applies to individual non-business income, with particular reference to the deductibility of expenditure of individuals in earning assessable income, including but not limited to an examination of comparable jurisdictions such as the United Kingdom and New Zealand; and
- The company income tax system, with particular reference to the deductibility of interest incurred by businesses in deriving their business income.

The committee had not reported when the House of Representatives was dissolved on 9 May 2016. The Treasurer, the Hon Scott Morrison MP, re-referred the inquiry on the 22 November 2016 and asked that it be concluded.



## List of abbreviations

|       |   |
|-------|---|
| ABA   | Australian Bankers' Association                           |
| ACCI  | Australian Chamber of Commerce and Industry               |
| ACOSS | Australian Council of Social Service                      |
| AFTS  | Australia's Future Tax System                             |
| ATO   | Australian Taxation Office                                |
| AVCAL | Australian Private Equity and Venture Capital Association |
| BEPS  | Base Erosion and Profit Shifting                          |
| BTWG  | Business Tax Working Group                                |
| CAFBA | Commercial Asset Finance Brokers Association of Australia |
| FBT   | Fringe Benefits Tax                                       |
| ITAA  | Income Tax Assessment Act                                 |
| OECD  | Organisation for Economic Co-operation and Development    |
| PAYG  | Pay-As-You-Go   |
| PBO   | Parliamentary Budget Office                               |
| TJN   | Tax Justice Network Australia                             |
| WRE   | Work-Related Expense                                      |



# List of recommendations

## 2 Personal income tax deductions

### Recommendation 1

The committee recommends that the Government maintain the current personal income tax framework that allows Australians to claim deductions for valid expenses, including those related to their work. The committee sees this as an entirely appropriate part of our taxation system.

While there are opportunities to improve the operation of the system, the committee supports the ongoing ability of Australians to claim legitimate deductions.

### Recommendation 2

The Committee recommends that the Australian Taxation Office be instructed to analyse each detailed subcategory of tax deductions and identify areas that it believes are particularly open to systemic abuse and overclaiming.

The Australian Taxation Office should then rank these subcategories in order of the size of the financial risk they represent to Government revenue, and recommend amendments to law or policy where appropriate.

### Recommendation 3

The committee recommends that Treasury be required as a matter of priority to provide a clear estimate of the actual cost to Government revenue of Work Related Expenses as necessary to properly inform policy in this area.

### Recommendation 4

The committee recommends that the Australian Taxation Office review its compliance activity in relation to Work Related Expenses. The fact that

\$100 million of abuse was identified in a single year through a review of one in one thousand taxpayers suggests that there is considerable scope in this area.

#### Recommendation 5

The committee recommends that the Australian Taxation Office continue with technological development and progress on pre-filing of returns to support the implementation of the reform agenda and to simplify taxpayers' interaction with the tax system, with the eventual goal to minimise, and ultimately remove, the need for taxpayers to amend pre-filled returns.

### 3 Company income tax deductions

#### Recommendation 6

The committee recommends that the Government maintain the current company income tax framework that allows the deductibility of interest incurred by businesses in deriving their income.

#### Recommendation 7

The committee recommends that the Government continue its important work on the implementation of the G20/OECD Base Erosion and Profit Shifting (BEPS) recommendations to further strengthen Australia's rules addressing tax integrity.