



Australian Government  
Australian Taxation Office

# Australian Taxation Office Submission

## Inquiry into Tax Deductibility

9 March 2017

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# Introduction

1. On 1 December 2015 the Treasurer the Hon Scott Morrison, MP, re-referred to the committee a short term inquiry into tax deductibility.
2. The committee will be considering 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 will 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.
3. As a key stakeholder, the Australian Taxation Office (ATO) was invited to give evidence at the inquiry's roundtable public hearing on 5 February 2016.
4. During the hearing various stakeholders discussed tax gap, pre-filling of tax returns, simplifying compliance and implementing the OECD base erosion and profit shifting recommendations. The Committee has requested that the ATO provide an update on these measures and initiatives.
5. This submission provides details on:
  - work-related expenses
  - work being conducted on tax gap estimates
  - technological development and progress on pre-filling of returns; and
  - measures to simplify compliance.
6. The Treasury submission will provide an update on measures implementing the OECD base erosion and profit shifting recommendations.

## Work-related expenses

7. 8.6 million taxpayers claimed a total of \$21.8 billion in work-related expenses in their 2015 tax returns, accounting for around 60 percent of total deductions. Of these, 7.5 million (87 per cent) are taxpayers who are not in business, claiming \$18.8 billion.
8. Claims have increased by 21 per cent over the past five years compared to salary and wage growth of 21.8 per cent and CPI growth of 12.2 per cent.
9. Car (\$9 billion, 3.4 million taxpayers) and other expenses (\$7.8 billion, 7 million taxpayers) account for 77 per cent of the total amount claimed. Uniform/clothing/cleaning is the most commonly claimed deduction.
10. 75 per cent of taxpayers with work-related expense claims lodge through a tax agent. Over the last five years, average claims for self-preparers have grown by 21 per cent and by 17 per cent for those using a tax agent.
11. For those who claim work-related expenses, \$2,000 is the average amount for self-preparers, and \$2,600 is the average for those who lodge through an agent. The median claim for self-preparers is \$785 and \$1,140 for those using an agent.
12. The high value, number of claims and array of different individual circumstances require the ATO to maintain a strong focus on personal deductions.
13. We are concerned about the level of non-compliance in relation to work-related expenses. While the amounts over-claimed by individuals are relatively small, they add up across the large population of individual taxpayers.

## Behaviours

14. Incorrect claims generally fall into three categories:
  - claims for items where the taxpayer did not spend the money
  - claiming for private expenses (not related to earning their income) or not correctly apportioning between private and work use
  - having no records or being able to prove the basis of the claims.
15. Specific examples of incorrect claims include:
  - car expenses for travel between home and work
  - travel between home and work on the purported basis of carrying bulky tools

- travel expenses for meals but not traveling overnight
  - travel expenses for ineligible private travel
  - uniform expenses for ineligible clothing
  - self-education expenses that do not relate directly to current work activities
  - other expenses such as home office claims where internet and mobile phone usage are not apportioned.
16. We see similar errors in returns prepared by both tax agents and self-preparers.
17. The majority of taxpayers try to do the right thing and make simple inadvertent errors. However, other behaviours we see are deliberate over-claiming and/or making false claims.
18. These behaviours can be influenced by a number of factors including:
- poor knowledge of what a tax deduction is
  - poor understanding of, or confusion about, what is genuinely deductible, leading to taxpayers who guess or take risks
  - false belief about what is genuinely deductible, leading to taxpayers who are confident in their claims, but wrong
  - social and third-party influencers who may promote a claiming culture, or perpetuate the myth that over-claiming is a low-risk activity
  - an entitlement culture, particularly amongst similar socio-economic groups: 'everyone else gets money back – I should too'.

## Our approaches

19. We continue to refine our strategies and tactics for managing work-related expenses, which are aimed at preventing non-compliance and increasing correct reporting. We continue to focus our efforts on help and education - designing products and services that make it easier for individuals to get their deductions right.
20. Our focus on work-related expenses labels includes leveraging our compliance activities through key intermediaries and providing tax agents with a risk picture of their client base.
21. The more sophisticated use of data is transforming the way we assess work-related expenses. For example, our Nearest Neighbour model allows us to risk-assess all taxpayers that make a work-related expense claim. The model compares a taxpayer's claims with those of their peers (earning similar income, in similar jobs) to determine how far they differ from the

norm. While a larger than usual claim might be legitimate, it will cause us to ask further questions.

22. This year we used this model by incorporating messages into myTax. Where we identified higher than expected claims, a message appeared asking taxpayers to review and correct any mistakes prior to lodgement. We have provided messages to around 111,300 taxpayers (3.5%) of the myTax lodgement population. While we don't know the taxpayer motivation for making changes, our analysis suggests that more than 15% of people who received the message subsequently reduced their work-related expenses claims.
23. Where we have concerns with a taxpayer's claims we take more direct compliance action. In 2015-16, the ATO undertook over 100,000 activities (a mix of tailored letters, pre-issue reviews, audits, and personal visits to tax agents) to improve correct reporting and address non-compliance at the work-related expense labels. These efforts resulted in almost \$93 million in revenue.
24. The effectiveness of our treatment strategies are challenged by a number of factors including:
  - almost any item purchased may be deductible in the right circumstances
  - the absence of third party data to validate work-related expense claims
  - rules for deductions are underpinned by complex law and numerous legal decisions and administrative rulings
  - attempts to simplify the system such as introducing exclusions to substantiation provisions are often misunderstood and misused, i.e. the taxpayer hasn't incurred the expense.

# Measures to simplify compliance

25. By delivering new and improved services and products, we have reduced the cost of compliance for individuals and businesses by over \$288 million in the 2016 calendar year. The ATO has contributed significantly to the Government's \$1 billion annual red tape reduction target with more than \$900 million in savings over three years.

## Individuals

26. myTax was upgraded for Tax Time 2016 making it available to all individuals who want to lodge their own tax return online. Around 3.2 million individuals used the improved digital service with some clients now taking just minutes to lodge a return. In October 2016, we launched web chat and screen-share when using myTax. Clients can share their myTax screen during a phone conversation, so our staff can better understand their enquiry and personalise their response.
27. The myDeductions tool in the ATO app allows taxpayers to save time and keep deduction records all in one place, regardless of whether they lodge their own return or use a tax practitioner. The ATO app was updated for Tax Time 2016 to extend the myDeductions tool's functionality to allow individuals to record their income and expenses 'on the go'. This new functionality includes recording car trips, expenses and income, emailing records to tax agents, and uploading records to the ATO to pre-fill tax returns.
28. We also continue to expand the range of self-help services available and in February 2016 we launched Alex the virtual assistant on our website to answer general questions from clients across a range of tax topics. So far Alex has engaged in over one million conversations and is estimated to save taxpayers over \$9 million per year.

## Small business

29. We continue to work with small business operators in leading the Small Business Fix-it Squads to design and implement a better client experience for small business. Squads are driven by small business and are made up of small business owners, intermediaries and representatives from the federal and state government agencies involved. These squads look at 'life events' such as starting a small business, taking on an employee, selling or closing a business and take a whole-of-client approach in designing products and

services for those events. From January 2016 to December 2016, the squads have reduced compliance costs for small business by \$140.6 million (ATO contribution of \$35.6 million).

30. Recently the squads examined the issues faced by young adults when starting a small business and provided a suite of targeted, tailored information and key reminders at regular intervals to assist these new businesses. Another area where small business owners indicated they needed support was when taking on a new employee as they have found the various state and federal regulations and awards confusing and had to search many places to find the right regulations that applied to them. To address these issues the fix-it squad implemented a range of improvements such as a whole-of-government checklist covering the regulation requirements and added more functionality to the existing Award Finder Tool and Pay and Conditions Tool.
31. As with individual taxpayers, myTax is now available for sole traders to lodge and amend their returns from any device. We continue to expand the options available for small business via the ATO app to assist them to manage their affairs anywhere and anytime. Sole traders are now able to capture transactions 'on the go' using myDeductions and send those records to their tax practitioner at the end of the year, or upload them directly to their return in myTax.
32. Clients and their advisors with tax or superannuation matters can also access the right person for advice by engaging with the ATO through a call back service and other online requests for advice through our website. These services provide access to tax experts and assist taxpayers to get things right. We tailor our advice based on their timeframes and the level of certainty they require. Engaging early and providing certainty to taxpayers about tax matters prior to lodging their returns reduces downstream disputes and associated costs.
33. We know a key irritant for businesses interacting directly with the ATO is the use of AUSkey for authentication. We introduced 'Manage ABN Connections' in June 2016 to allow individuals in business to use their myGov username and password to access our online business services as an alternative to AUSkey.
34. From 1 July 2017, 'Simpler BAS' will be the standard reporting option for all small business. Simplifying the BAS will ease the reporting burden on small business and reduce the amount of GST bookkeeping and reporting required.



## Larger taxpayers with more complex affairs

35. We have actively pursued options to simplify compliance for larger taxpayers with more complex affairs. Our continued emphasis on early engagement, encouraging taxpayers to speak to us at an early stage to seek advice on complex or sensitive transactions, reduces the likelihood of costly disputes arising in the future.
36. Early engagement on business restructures, our pre-lodgment compliance review and tailored compliance engagement projects were reported to save \$9.3 million in 2016. We anticipate further benefits from our Key Taxpayer Engagement approach, providing an integrated, whole of tax engagement approach for the top 100 public corporate taxpayers.
37. We have established relationship teams for our largest privately owned and wealthy group taxpayers where we have an ongoing one on one relationship with them tailoring our interactions and engagement based on their circumstances. We are transparent about what attracts our attention and work with taxpayers to get things right, including embedding good tax governance to manage their risk and obligations and resolving potential issues prior to lodgment. This tailored approach to encourage and influence taxpayers to get things right upfront reduces the cost of compliance.
38. We also provide “safe harbours” for taxpayers where we outline practical approaches that taxpayers can use which reduce their compliance costs, but still meet the legislative intent. We publish these safe harbours in documents called “Practical Compliance Guidelines”.
39. The following safe harbours were published this financial year:
  - simplified record keeping requirements for employers with large fleets to determine the taxable value for car fringe benefit purposes (reported to save \$3.1 million in a six month period)
  - ‘fair and reasonable apportionment’ of taxable fuel for the purposes of determining fuel tax credits (reported to save \$310,000 in a six month period)
  - GST countertrade transactions (reported to save \$2.4 million in a six month period).
40. For taxpayers with international dealings we have recently published guidelines:
  - setting out our compliance approach to transfer pricing issues relating to centralised operating models, which are commonly used for activities such as marketing, sales and distribution

- providing seven transfer pricing documentation simplification options, replacing former web guidance.
41. These safe harbours are reported to contribute \$38.2 million in red tape reduction savings.
  42. We use taxpayer alerts to express our concerns quickly to the community about tax arrangements that are causing us concern, but where we are still finalising our views. This allows taxpayers and their advisers to make informed decisions and avoid costly disputes arising from inadvertently taking risky positions. We encourage taxpayers to seek advice from an independent adviser or us if they are considering entering similar arrangements to prevent potential non-compliance. We have published 11 taxpayer alerts this financial year covering a range of the most significant issues.
  43. In addition to Practical Compliance Guidelines and taxpayer alerts, we introduced Law Companion Guidelines in late 2015 to support new legislation by providing advice on how we will practically administer the legislation. Law Companion Guidelines allow legislation to be drafted in a more principle based way to be more flexible in adapting to changing business models. They are drafted alongside the legislation and become public rulings when the legislation is enacted.
  44. We have co-designed with industry a Tax Risk Management and Governance Guide and supplementary Directors Handbook to assist companies and their directors to implement appropriate tax governance for their organisations. These documents set out what the ATO considers to be a scalable 'better practice' governance framework that organisations can have regard to in designing and assessing their own governance arrangements.
  45. We have developed a tool allowing large corporate taxpayers to use their independent auditors to complete factual checks on our behalf, ideally during preparation of their financial statements, to address identified issues thereby reducing additional compliance costs. In all cases the information is provided to the ATO and final decisions are made by ATO officers.

## Pre-filling of returns

46. What started as a pilot in 2005, allowing a group of e-tax users to import their Medicare Financial Tax Statement data into e-tax, has seen the expansion of pre-fill data to over 80 million records in Tax Time 2016.
47. Prefilling of data into tax returns helps make it easier and faster for taxpayers to complete their tax return. It minimises omitted or incorrectly reported income and other errors for individuals and has been received very positively by the community. It also assists tax practitioners in their tax preparation work for their clients.

## Progress on pre-filled returns

48. We receive third-party data reporting from government agencies, private health funds, financial institutions and companies that is used to pre-fill returns. This includes data on employment income, tax withheld, interest, dividend and managed fund payments. As at January 2017, over 3.2 million individuals self-prepared their return through myTax with pre-filled data.
49. We only pre-fill data where we are confident we have matched the data to the right individual. We work closely with third party reporters to strengthen the quality of data.
50. Of the 80 million records pre-filled in Tax Time 2016, we received less than 30 related complaints concerning the accuracy of the data.
51. Active engagement with our data providers has resulted in most data being lodged significantly earlier than previous years. In Tax Time 2016 we reached an 80 percent benchmark for our pre-fill data by 18 July, well in advance of legislated reporting dates (14 August for employers and 31 October for financial institutions). 62.6 million pre-fill records were received by 18 July in comparison to 49.7 million records for the same time in 2015.
52. The myDeductions tool in the ATO app allows taxpayers to save time and keep deduction records all in one place, regardless of whether they lodge their own return or use a tax agent. In 2016, over 55,000 clients uploaded their completed deductions to the ATO so that their individual income tax return was pre-filled. Clients can also share their deductions data via email with their tax agent so they can pre-fill the return or review the deductions prior to lodgement. However, the accuracy of this data depends on the taxpayer keeping full and correct information of their deductions.

## Compliance and pre-fill

53. Regardless of whether income is pre-filled or manually entered into a tax return it is still the responsibility of the individual to make sure all their income details are included and correct. Pre-filled information can be amended or deleted if the taxpayer has information that is more current. We actively advise taxpayers and tax professionals that they need to review the pre-filled information.
54. If a taxpayer is able to show the information accepted in pre-fill was incorrect we will work with them to ensure an accurate assessment and the provider of the data to improve the quality into the future. No administrative penalty is applied in these cases.
55. Pre-filling returns helps reduce the errors taxpayers make when completing their return and we are seeing a decline in the number of cases requiring review and correction. In Tax Time 2016 we reviewed approximately 260,000 returns which were lodged prior to the majority of pre-fill data being available. Nine out of 10 returns were adjusted as a result of our inquiries to include omitted income.

## Further improvements

56. Over the next two years we are expanding the range of information that will be available in our pre-fill service to assist individuals and their tax agents to correctly prepare their return as easily as possible.
57. From Tax Time 2017, we will alert taxpayers via our pre-fill service to information we hold about real property they have disposed of during the year to support the correct calculation and reporting of capital gains or losses resulting from real property sales. Under recent legislation, this data is now reported to us automatically each quarter by State and Territory land title offices.
58. In addition, from Tax Time 2018 we also expect to pre-fill information about a taxpayer's sales of shares and units to assist with full and correct reporting of these transactions. This will be achieved under recent legislation through more systematic reporting of this information from share registries and other investment bodies.
59. More generally, we are currently working with financial institutions including Australia's largest banks to identify how emerging technologies could help the ATO receive data about an individual's income and investments much more regularly during the year. We are examining how more regular, 'real time' reporting of this data could assist individuals in managing their tax affairs during the year, ensure data is available even closer to the end of the financial year to

support return preparation and reduce the data reporting effort for financial institutions and other reporters.

60. The incoming Single Touch Payroll regime is another example of how the ATO is supporting more 'real time' reporting of an individual's income information throughout the course of the year. Under this regime, employers can report salary or wages, pay as you go (PAYG) withholding and super information to us from their payroll solution, at the same time they pay their employees.

# Tax gap estimates

61. In the *Commissioner of Taxation Annual Report 2015-16* the ATO refreshed previously published tax gap data with the exception of the beer excise and duty estimate. (See below.)
62. The beer excise and duty estimate was withdrawn due to identified data quality issues. The ATO is exploring alternative approaches and data sources to support a more reliable estimate, as well as looking to expand it to incorporate spirits and ready to drink beverages.
63. Similarly the ATO has delayed releasing other gap estimates due to the need to undertake further work to ensure that the estimates are as reliable and credible as possible.
64. While continuing to refine the income tax gap estimates for large companies and high wealth individuals, we have concluded that re-segmentation of the remaining income tax population is required to allow for clearer understanding and communication of the issues facing each segment of the population. As such we have restructured the individuals and small and medium companies segments as follows:
  - Individuals (not in business)
  - Small Business
  - Medium Companies.
65. The ATO is developing approaches and methodologies that will estimate and explain the level of willing participation in the system by these taxpayer segments. As part of this we recognise the importance of adequately factoring in impacts of the non-observed economy to produce more informed estimates.
66. The ATO will continue to draw upon the experiences of other international tax administrations, engage tax gap expert consultants and consult with other government agencies (including Treasury) to develop methodologies suitable for the Australian tax environment. The assessment of the reliability and credibility of the estimates is informed by advice and guidance from an independent expert panel.
67. Random enquiry programs are recognised internationally as best practice for obtaining quality data to produce reliable and credible estimates for large and homogenous taxpayer populations. For this reason and as recommended from our expert panel, we are continuing to implement these programs to inform our Individuals, Small Business and Medium Company estimates.

68. Our position is that gap estimates should be released only when the estimates are sufficiently reliable and credible.

## Tax Gap - *Commissioner of Taxation Annual Report 2015-16*

**TABLE 2.8 Net tax gap estimates – Indirect taxes, 2011–12 to 2015–16<sup>(a)(b)(c)(d)</sup>**

Reliability assessment			2011–12	2012–13	2013–14	2014–15	2015–16
Taxes on goods and services							
GST	Medium	%	7.0	7.0	5.8	6.1	6.5
		\$m	3,450	3,550	3,000	3,360	3,780
Luxury car tax <sup>(e)</sup>	Medium	%	5.8	4.6	5.1	4.7	5.2
		\$m	30	25	25	25	30
Wine equalisation tax <sup>(f)</sup>	Low	%	4.1	4.9	0.5	5.9	na
		\$m	40	50	5	70	na
Excise and customs duties							
Petrol and diesel	Medium	%	0.5	0.5	2.4	2.2	0.8
		\$m	75	75	405	370	135

a. GST rounded to the nearest \$10 million, all other smaller revenue streams rounded to the nearest \$5 million.

b. Beer excise and duty gap estimate has been withdrawn due to identified issues with data.

c. Changes from previously published estimates are due to revisions to ABS data, updated ATO data and a modified approach to determining liabilities reported but not paid. Revisions to the estimates occur over time for a variety of reasons, including improvements in methodology, revisions to external data and additional or updated data becoming available.

d. Due to data lag, the data for the reporting period 2015–16 relates to gap estimates in the tax year 2014–15. This same rationale applies for prior years.

e. Estimate for luxury car tax payable only, not taking into account luxury car tax refunds.

f. Estimate for wine equalisation tax payable only, not taking into account wine producer rebates.

**TABLE 2.9 Net gap estimates – Programs we administer, 2011–12 to 2015–16<sup>(a)(b)(c)</sup>**

Reliability assessment			2011–12	2012–13	2013–14	2014–15	2015–16
<b>Administered programs</b>							
Pay as you go (PAYG) withholding	Low	%	2.9	3.0	2.1	1.4	na
		\$m	3,780	4,350	3,240	2,140	na
Fuel tax credits	Medium	%	0.6	0.8	0.6	0.6	–0.4
		\$m	30	45	30	35	–25

a. PAYG withholding rounded to the nearest \$10 million; fuel tax credits rounded to the nearest \$5 million.

b. Changes from previously published estimates are due to revisions to ABS data, updated ATO data and a modified approach to determining liabilities reported but not paid. Revisions to the estimates occur over time for a variety of reasons, including improvements in methodology, revisions to external data and additional or updated data becoming available.

c. Due to data lag, the data for the reporting period 2015–16 relates to gap estimates in the tax year 2014–15. This same rationale applies for prior years.



