



9 February, 2017

Mr Kevin Hogan MP  
Chair  
Standing Committee on Tax and Revenue  
Parliament House  
Canberra ACT 2600

Dear Mr Hogan

## INQUIRY INTO TAXPAYER ENGAGEMENT WITH THE TAX SYSTEM

The Treasury is pleased to provide you with a submission to the Committee's inquiry.

As a central policy agency, the Treasury provides advice from a whole-of-economy perspective on effective tax arrangements, including the general design of the tax system, and prepares implementing legislation to give effect to Government decisions. To help inform our policy advice and tax law design practices, we regularly engage and consult with a range of taxpayers and taxpayer groups.

Whilst other Government agencies, such as the Australian Taxation Office (the ATO), the Inspector-General of Taxation (the IGT) and the Tax Practitioners Board (the TPB) have more direct relationships with taxpayers and tax practitioners, the Treasury has a keen interest in the tax system's overall performance and the experience of taxpayers.

We consider this inquiry to be both timely and essential for the successful operation of Australia's tax system, particularly as it provides an opportunity to inform and shape the future direction of how the community interacts and engages with it.

The inquiry also provides an opportunity to build on recent reviews into the tax system, including, for example, Australia's Future Tax System Review and the more recent Tax White Paper Process<sup>1</sup> as well as the ATO's Reinvention Program and the transfer of the individual tax-complaint handling function to the IGT in 2016<sup>2</sup>.

Relevantly, it aligns with the Government's digital transformation agenda, the Government's commitment to reducing red-tape through the Regulator Performance Review Framework, the work of the Behavioural Economics Team of the Australian Government (BETA) and the recently announced Black Economy Taskforce<sup>3</sup>.

As an overarching policy principle, the objective of an efficient tax administration is to collect the correct amount of revenue with minimum administration and compliance costs. This is particularly important in Australia where a significant amount of Australia's tax revenue comes from taxpayers who pay voluntarily on time, and with little intervention from the ATO.

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<sup>1</sup> As the Committee notes in its explanatory paper, Australia's Future Tax System Review envisaged a 21st century tax system that would allow taxpayers to engage with it in ways that meet their needs and preferences. More recently, the Re:Think Tax Discussion Paper explored ways for managing complexity within the tax system, including an increasing role for the tax administrator to minimise the impacts of complexity for taxpayers.

<sup>2</sup> The IGT announced his forward work program for 2017 on 31 January 2017, and a copy of it is available on the IGT's website ([www.igt.gov.au](http://www.igt.gov.au)).

<sup>3</sup> The Hon Kelly O'Dwyer MP, 'Black Economy Taskforce' 14 December 2016.

However, in undertaking this inquiry, the Committee may wish to also consider how initiatives that improve the experience of those taxpayers who wish to engage with the tax system might also help reduce the incidence of taxpayers choosing not to engage with the tax system.

We have prepared this submission to draw out some key policy-related themes and trends that are likely to affect how taxpayers will engage with Australia's tax system in the future. Given the Committee's terms of reference also include an examination of how behavioural insights and 'nudges' can improve the experience of taxpayers, we have also attached some general observations about how Randomised Control Trials can help inform policy design and administrative practice ([Attachment A](#)).

## Maintaining and designing robust tax policy and legislative frameworks

### *Maintaining existing regulatory frameworks*

Over time, regulatory frameworks can become impaired for a number of reasons. For example, they can be unnecessarily complex as a result of multiple amendments, they can become outdated as a result of technology moving on, or they may give effect to policies that have ceased to be relevant.

Looking at regulatory frameworks as national assets makes it easier to conceptualise how, over time and without proper maintenance, they can become out of date, unnecessarily complex and no longer fit for purpose. The implications of not maintaining our regulatory frameworks — resulting in increased complexity and a higher compliance burden on individuals, business and the community — are significant.

Consequently, Treasury has committed to a rolling series of reviews of regulatory frameworks to ensure that:

- the original regulatory objectives are still sound and the regulation is still required;
- the regulation achieves those objectives in the most efficient and effective way;
- there are no barriers to competition or other unintended consequences, and the expected balance of cost to benefit came to pass (to inform future action); and
- the framework of law and subordinate regulatory instruments provides the flexibility to accommodate new business models and technologies as they emerge.

### *Using principles-based legislative frameworks*

Furthermore, choices made in developing policy and legislation can shape and influence how taxpayers engage with the tax system. For example, in designing legislation, there is often a trade-off between, on the one hand, demands for the law to be specific about particular outcomes (this is sometimes referred to as 'certainty') and, on the other, flexibility in managing future developments in such a way as to not leave the tax consequences of those transactions unaddressed or unclear. While the former can appear attractive at first instance, in that it settles a particular issue, it does little for the unknown instances not addressed and, over time, the proliferation of extra detail makes the legislation complex for everyone.

As such, whilst providing prescriptive rules can readily address particular (known) outcomes, simpler and more principled frameworks may allow for flexibility in administration and better manage the transition to new developments. Under this approach, enduring principles, which clearly reflect the policy outcomes intended by Parliament, would be enshrined in primary legislation. The additional detail necessary to provide certainty and address specific scenarios could be provided in ways that do not require constant Parliamentary intervention, such as through lapsing regulation or other instruments, or through taxation rulings.

As an example of such an approach, the Government introduced amendments into Parliament last year to provide investors, who invest in early stage innovation companies with high growth potential, with a tax offset and capital gains tax exemption for their investments.<sup>4</sup> A key part of these amendments was defining those companies that satisfy an ‘innovation’ limb in the qualifying conditions. To provide ‘enough legislative flexibility to accommodate both existing and future forms of innovations’<sup>5</sup> the amendments started with a principled definition of innovation and supplemented it with specific objective criteria that could be subsequently adjusted through regulations.<sup>6</sup>

## Greater use of third-party data and pre-filled information for taxpayers

### *Australia’s self-assessment system*

Australia’s income and indirect tax systems currently operate on a self-assessment basis. This means taxpayers are responsible for providing the ATO with accurate information and ensuring their returns comply with the law. Whilst the ATO generally accepts the accuracy of information provided by taxpayers, there is a period of review in which the amount of tax payable, or refundable, may be reviewed and amended. In some cases, taxpayers that don’t provide accurate information and have a tax shortfall may be subject to interest payments, administrative penalties as well as having to pay the shortfall amount. Many taxpayers choose to engage tax practitioners as a way of managing these interactions.

As the IGT noted in his 2015 report, *The Australian Taxation Office’s services and support for tax practitioners*, the level of taxpayer reliance on tax practitioner services began to significantly increase following the introduction of the self-assessment system in the 1980s and (to a lesser extent) in response to:

- complexity of business operations and related regulations;
- individual taxpayer involvement in investment activities and income sources other than personal exertion;
- scope and complexity of tax law and related compliance; and
- use of the tax system to deliver social policies as well as to collect revenue.<sup>7</sup>

As a result, the proportion of taxpayers using tax practitioners has increased from only 20 per cent of individual taxpayers in 1980 to over 70 per cent of all individual taxpayers (8 million) and 90 per cent of all business taxpayers (2 million) in 2013–14. Australia’s reliance on tax agents are among the highest in OECD countries.<sup>8</sup>

### *Recent trends in using third party data*

Over the last 10 years, there has been an increase in the information available for the ATO to pre-fill for individual taxpayers. Whilst Australia’s income tax system is designed to operate on a self-assessment basis, the ATO has started a pre-filling service as a way of making tax returns more accurate and easier to

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<sup>4</sup> Tax Laws Amendment (Tax Incentives for Innovation) Act 2016. There is a discussion about the use of principles in defining the ‘innovation’ qualifying limb in pages 16-19 of the explanatory memorandum to the amending Bill.

<sup>5</sup> Explanatory memorandum, Tax Laws Amendment (Tax Incentives for Innovation) Bill 2016, page 18.

<sup>6</sup> As noted on page 17 of the explanatory memorandum, ‘These different tests recognise that whilst objective tests are easier to apply in Australia’s self-assessment income tax system, companies may be innovating in a variety of different ways and so may need to apply a combination of different tests depending on their circumstances.’

<sup>7</sup> The Inspector-General of Taxation, ‘The Australian Taxation Office’s services and support for tax practitioners’, paragraphs 1.6 and 1.7.

<sup>8</sup> The Inspector-General of Taxation, ‘The Australian Taxation Office’s services and support for tax practitioners’, paragraph 1.8.

complete. In essence, the ATO provides the information it has traditionally received for post-lodgement compliance purposes directly to the taxpayer by adding it to the relevant tax return label or giving it in a summary form. In some cases, this requires third parties providing information to the ATO earlier than legislated timeframes.

With effect from 1 July 2016 (and with some elements taking effect from 1 July 2017), new third party reporting regimes will begin to provide the ATO with additional information in relation to:

- payments of government grants and government payments for services;
- transfers of shares, units in unit trusts and real property; and
- business transactions made through payment systems.<sup>9</sup>

However, collecting third party data imposes some compliance costs on those third parties required to give information to the ATO. At a high level, this involves a policy trade-off between the compliance benefits to taxpayers and the tax system of improved ATO data-matching capabilities and the compliance burdens on third party reporters. To the extent that third party reporting obligations are imposed only on those entities that already collect the required information in the ordinary course of their business or activities and are integrated into existing business systems, then overall compliance costs will be reduced.

There is also a natural limit to the amount of information that the ATO can receive, and pre-fill, from third parties. For example, the ATO cannot pre-fill information that is known only to the taxpayer or information held by third-parties that doesn't contain sufficient identifying information to allow the ATO to match it to the relevant taxpayer. Deductions such as work-related expenses and donations to deductible gift recipients (DGRs) typically fall into this category. That said, there may be other administrative opportunities that can improve how taxpayers provide this information to the ATO, rather than just defaulting to an annual income tax return.

*Providing the opportunity to engage with taxpayers more frequently*

In addition, having third parties provide further and more frequent information to the ATO creates opportunities for the ATO to engage with taxpayers throughout an income year (should the taxpayer wish), rather than just when the taxpayer needs to lodge a return with the ATO.

As an example, Single Touch Payroll (STP) reporting will allow employers to automatically report payroll and superannuation information contained within their payroll system to the ATO at the same time as they pay their staff. Legislation implementing this initiative was passed last year and the changes will take effect from the 2018-19 income year. It will be mandatory for businesses with 20 or more employees to report through STP from 1 July 2018 whilst smaller businesses can voluntarily report using STP.

Currently, employers report and pay their aggregated Pay-as-you-go (PAYG) withholding obligations up to three months after the payroll event being when the relevant payment is made on the Business Activity Statement (BAS). STP provides an opportunity to streamline these processes by following the natural process of employers running their payroll and enabling ATO reporting through Standard-business reporting (SBR) enabled software at the same time. Through STP, employers will be able to report employee salary and wage information and superannuation guarantee obligations to the ATO at each pay run and will be removed of the obligations under taxation laws to separately report this information in other ways, such as providing payment summaries to their employees at year end.

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<sup>9</sup> As noted on page 61 the explanatory memorandum to Tax and Superannuation Laws Amendment (2015 Measures No 5) Bill 2015 (the implementing legislation for these changes), 'Developing a comprehensive and robust third party reporting regime has the potential, over time, to provide opportunities to change how individuals and other self-assessment taxpayers interact with the tax system in the future.'

STP reporting will require employee-level superannuation contribution information to be provided to the ATO at the time payments are made. Currently, the ATO only receives information about superannuation amounts paid to employees from superannuation funds up to four months after the end of the financial year. This can be as much as 16 months after the amounts are paid. Under STP, employers are required to provide details of employee payments when they send them to the superannuation fund. This will improve the ATO's ability to monitor the payment of employee entitlements and enable the ATO to implement earlier intervention processes if superannuation guarantee contributions are not being paid.

STP will also allow employees to view their employment related taxation and superannuation information via myGov, enabling individuals to keep track of cumulative employment related income and tax and superannuation contributions in one place. In addition, STP provides a new electronic employee commencement process where employees can complete forms such as TFN declaration and SuperChoice form using pre-filled data.

*What could these changes mean for taxpayer engagement?*

Cumulatively, these changes may have the potential to 'time-shift' some of the assumptions underpinning the current self-assessment regime — that is, that taxpayers are best placed to directly provide information to the ATO via an annual income tax return or other periodic report — to a system more akin to an end-of-year reconciliation of a taxpayer's affairs.

However, from a policy perspective, we see community support and confidence in using (and relying on) third party data as being critical in improving the experience of taxpayers. In particular, it is important that the increasing use of this information does not 'sour' particular experiences of taxpayers or create a broader perception within the broader community of problems with using this information. Similarly, taxpayer acceptance of digital technologies will depend on confidence in these systems and assurance that these digital systems are secure and stable and do not entail duplication of effort.

From a taxpayer perspective, we see two main structural issues arising from an increasing use of pre-filled third party information that will need to be carefully managed. The first is assessing how well the pre-filled information accurately represents a taxpayer's tax position (based on the information provided and any information not provided) and the second is who carries the risk of any tax shortfalls (and penalties) arising from inaccurate information. Both issues may also affect the third party's relationship with the taxpayer.

For example, some taxpayers that receive reported information may choose to assure themselves by independently verifying that the information is correct. In this case, extending pre-filled information is likely to be of diminishing compliance benefit to the taxpayer. By contrast, other taxpayers may readily choose to accept the pre-filled information and later on, should that information turn out to be inaccurate, may be exposed to administrative penalties for providing incorrect information to the ATO (in addition to paying any shortfall amounts). This is likely to have future behavioural affects and may lead to that taxpayer having in a lack of confidence in the tax system. Neither outcome is desirable.

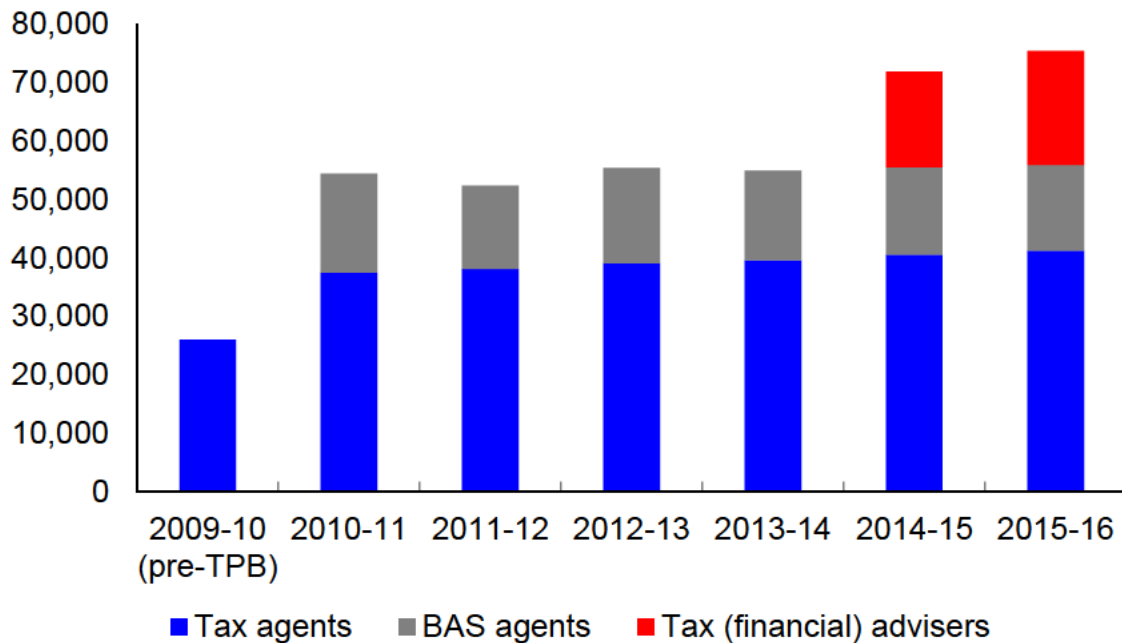
A more detrimental outcome could arise in situations if a taxpayer (for whatever reason) chooses not to challenge or amend pre-filled third party information that has the effect of overstating their tax liability.

As such, the Committee may wish to explore with the Australian community, how the tax system can best foster this support and confidence and, if there are any existing structural impediments, how these impediments could be overcome or what safeguards may be instituted to maintain community support.

**A possible changing role for tax practitioners**

As noted above, tax practitioners and other intermediaries currently play a significant role in the operation of Australia's tax system. Whilst tax practitioners assist individual taxpayers meet their obligations, they also play an important role in strengthening the integrity of the tax system. Maintaining a sound regulatory environment for tax practitioners plays a key role in ensuring this outcome.

In 2015-16, there was a total of 75,436 tax practitioners in Australia and the following chart shows how these numbers have changed since 2009-10 (just before the TPB was established).



Source: Tax Practitioners Board annual reports.

Given these broader trends for greater use of third party data and pre-filling of tax returns, it is likely that there will be changes in how taxpayers, and particularly individuals and small businesses, choose to engage tax practitioners and other intermediaries in managing their tax affairs in the future. Ultimately this will be a matter for individual taxpayers.

In conclusion, we look forward to the Committee’s findings from this inquiry in due course.

Furthermore, given the breadth of Australia’s tax system and the ongoing impacts it has on the Australian community, the Committee may wish to consider whether there would be merit in conducting these types of inquiries on taxpayer engagement from time to time.

We would be pleased to discuss any of these issues further with the Committee.

Please contact \_\_\_\_\_ if you have any queries in relation to our submission.

Yours sincerely

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## Applying behavioural insights and randomised control trials — some general observations

The application of behavioural insights to tax policy or administration requires an ‘experimental mindset’ as it is through testing these insights via Randomised Controlled Trials (RCTs) that best determines whether the changes will have the desired impact. RCTs produce the most compelling form of evidence of impact because they make it possible to isolate the effect of a program from complicating factors, even those that are unseen.

A methodological shift towards such an experimental mindset would recognise the following points.

- There is often uncertainty at the design stage about which policy or administrative arrangement will be most effective and so exploring and testing different options, allows for better informed decisions.
- It takes time and additional expertise to conduct RCTs to test which arrangements are most effective.
- In some cases, RCTs may demonstrate that policies or arrangements are counterproductive and should be discarded (or amended and tested again).
- Despite RCTs being the ‘gold standard’ for evaluating behavioural impacts, if an RCT is not feasible other quasi-experimental evaluation techniques could be used instead to study the impacts of potential changes. These include regression discontinuity, matching methods, or sequencing and then randomising the date of policy implementation to create a ‘natural experiment’.<sup>10</sup>
  - While quasi experimental approaches provide a valid approach to impact evaluation in certain circumstances, they also typically require stronger assumptions about the role of unobserved characteristics on the observed outcomes.

RCTs do not have to cost a lot of money. With technological advancement around data collection and analytics, conducting a properly planned and well-designed RCT could potentially be cheaper than other forms of evaluation.

With the help of the Behavioural Economics Team of the Australian Government, this change in mindset is already occurring across the wider APS (including within the ATO and Treasury). However, this change also has implications beyond the bureaucracy to the way decision makers, commentators and the public all approach broader policy and administrative issues.

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<sup>10</sup> For example, in 2009 the ATO randomised the timing of delivery of fiscal stimulus payments by postcodes. Academics were then able to exploit this ‘natural experiment’ to study the impact of the payments on household consumption — see Aisbett, E, Brueckner, M, Steinhauser, R and Wilcox, R (2013), “Fiscal stimulus and households’ non-durable consumption expenditures: evidence from the 2009 Australian Nation Building and Jobs Plan”, <https://www.cbe.anu.edu.au/researchpapers/cepr/dp689.pdf>