

**Submission by the
Commonwealth Ombudsman**

**Response to Discussion Paper on
Making tax time simpler**

**Standard deduction for the cost of work related
expenses and the costs of managing tax affairs**

CONSULTATION BY THE TREASURY

INTRODUCTION

On 11 May 2010 the Treasurer announced that the Australian Government would provide individual taxpayers with an optional standard deduction for work-related expenses and the cost of managing tax affairs.

The 2 March 2011, the Hon Bill Shorten MP, Assistant Treasurer and Minister for Financial Services and Superannuation, released a discussion paper on the design and scope of the standard deduction.

The discussion paper proposes that the standard deduction will be \$500 for 2012-13, rising to \$1,000 for 2013-14 and subsequent years.

It will replace work-related expenses (WRE) and the cost of managing tax affairs for those taxpayers whose claims for these expenses are less than the standard deduction.

Taxpayers whose claims for these expenses exceed the standard deduction will still be able to claim those deductions.

COMMONWEALTH OMBUDSMAN

The Commonwealth Ombudsman safeguards the community in its dealings with Australian Government agencies by:

- achieving improvement in policy, process and procedural practice arising from administrative deficiencies or systemic failure, as identified through independent review of complaints about Australian Government administrative action
- fostering good public administration that is accountable, lawful, fair, transparent and responsive
- assisting people to resolve complaints and/or remedies to injury arising from government administrative action
- developing policies and principles for accountability.

The Commonwealth Ombudsman, as established through the *Ombudsman Act 1976*, is also the Taxation Ombudsman. The Taxation Ombudsman focuses on investigating complaints from taxpayers and tax professionals about the administrative actions of the Australian Taxation Office (ATO) and related entities such as the Tax Practitioners Board.

BACKGROUND

The Taxation Ombudsman deals daily with taxpayers and tax agents experiencing difficulties with the ATO.

In the current financial year, complaints from taxpayers or tax agents have almost doubled the number of complaints received for same period last year. The last time we received such a large number of complaints about the ATO was coincided with the introduction of the new tax system (primarily the Good and Services Tax) and the ATO's handling of the mass marketed schemes.

The introduction of Goods and Services Tax (GST) provided some useful lessons for the ATO. Complaints received early in the introduction phase indicated that although there was sufficient information, generally taxpayers did not have a good understanding of how the system worked or

how to engage with the system. In fact, complaints remained high for the first 3¹ years while the ATO bedded the system down.

More recently, the Ombudsman released an own motion report in September 2010² on the ATO's management of compromised tax file numbers (TFN). This report highlighted key areas for improvement arising from the ATO's responses to a number of TFN compromise complaints referred from this office. Apart from the obvious issue regarding the ATO's failure to respond appropriately to problems arising from compromised TFNs, other inadequacies identified were in the areas of:

- policy oversight and recognition of the systemic issues revealed by complaints to the Ombudsman
- communication with affected taxpayers.

It is with these factors in mind that we comment on the proposed design and scope of the proposed optional standard deduction for WRE and the cost of managing tax affair.

ISSUES

Once legislation is introduced, clear regulations and instructions become an important element of the design of the proposed optional standard deduction for WRE and the cost of managing tax affairs. Taxpayers need to understand the differences between the current deduction regime and the proposed standard deduction program.

The comments below outline our concerns with the proposal. Our comments generally relate to issues which need to be considered by the ATO when implementing the proposed changes.

Exclusions

As outlined in the discussion paper, the proposed standard deduction will be available to all taxpayers, regardless of whether they have actually incurred any WRE or costs of managing tax affairs.

The ATO website contains clear information to taxpayers (individuals³) in answer to the question "Do I need to lodge a tax return?" The information makes reference to individuals who are Senior Australians, under 18 years of age or non-residents, as well as other individuals who may be in receipt of income from shares or rental income.

It is not clear from the discussion paper if "all taxpayers" actually includes *all* taxpayers, or if there are specific exclusions.

Substantiation and record keeping burden

Instructions to taxpayers (eg Tax Pack 2010⁴) who currently claim WRE, focus on the need to be able to substantiate the claim for the deductions. Where the claim exceeds \$300, taxpayers must also be able to provide written evidence for the whole amount of the deduction, not just the amount over \$300. Taxpayers must also have incurred the expense.

¹ *In the fourth year of operation of the new tax system, taxpayers generally have a better understanding of the way the GST operates* Commonwealth Ombudsman Annual Report 2003-04

² Report Number 12 *Australian Taxation Office: Resolving Tax File Number Compromise September 2010*. Commonwealth Ombudsman Canberra

³ Do I need to lodge a tax return?

<http://ato.gov.au/individuals/content.asp?doc=/content/16131.htm&mnu=42605&mfp=001/002>

⁴ TaxPack 2010 (page 26) Basic Rules

The discussion paper states that the aim is to reduce the burden on taxpayers to comply with the record keeping requirements of the tax law. Quoted statistics indicate that a significant number of taxpayers would be advantaged by a standard deduction. However, the statistical information does not link taxpayers who claimed both the WRE and expenses incurred in managing tax affairs deductions. It is difficult to infer the likelihood of these taxpayers claiming the standard deduction of \$500 in the first year, from this information.

Comments made by the Commissioner of Taxation, Michael D'Ascenzo in a speech to the Tax Institute of Australia⁵ provide a clearer basis to infer the possible take-up rate for the standard deduction:

“Of the 12.3 million individuals that lodged a return in 2008-09, approximately 8 million claimed work-related expenses with the average claim being \$2039. Both the number of individuals, and the average and total amounts claimed have increased steadily over the past 10 years”.

Future discussion regarding the benefits of this initiative should more clearly state the expected take-up based on figures available to the Commissioner.

Should the proposed standard deduction be introduced, the burden on a large number of taxpayers may further be reduced if the ATO were to use much of the information already reported to it or obtained under the pre-fill program to complete much of the return for taxpayers.

To assist others that decided to not take advantage of the standard deduction and claim in excess of \$500, consideration should be given to how these people can be further assisted to meet the burden of the record keeping requirement of the law. For example, TaxPack 2010 contains worksheets to assist taxpayers to calculate the deduction for Work-related self-education expenses and Low Value Pool. Consideration should be given to providing a table/worksheet so that taxpayers can record their individual items and reference evidence (eg logbook, receipts, etc). This would also serve to reinforce awareness of the record keeping requirements.

Income matching and audit

Successive ATO compliance programs⁶ specifically target WRE deductions as a focus of compliance activity. In past years⁷, a number of occupation groups were selected for specific focus because they had:

- above average WRE claims
- a high number of WRE claimants, or
- because the ratio of WRE claims are high compared to the salary and wages

As these occupation groups are not likely to utilise the standard deduction (for reasons identified in the compliance programs), consideration should be given to targeting communications and instructions to these specific occupation groups to:

- assist with understanding of the new system and the record keeping requirements
- indicate known benchmarks so that taxpayers in these groups can be better informed of known standards.

The discussion paper states:

“While the general principles underlying deductibility for WRE are simple, many Australian Taxation Office rulings, court rulings and legislative provisions underpin their application.”

⁵ Better information, better service, better support Commissioner's address to the Tax Institute of Australia National Conference, Brisbane, Thursday 3 March 2011.

⁶ Compliance program 2010-11 – Work related expenses, page 8

⁷ As exemplified in 2007 Compliance program - Work-related expenses in 2007
<http://www.ato.gov.au/corporate/content.asp?doc=/content/85364.htm>

The general principles underlying deductibility for WRE may be simple however apparently not for taxpayers. References to “common mistakes” in ATO publications⁸ suggest that the process and requirements are more complex and difficult for taxpayers to understand.

The design of a standard deduction process and the associated instructions and procedures need to be clear and concise. Testing and consultation by the ATO should include members of the identified occupation groups who make “common mistakes”. Because of the confusion usually associated with the first years of implementation of a new initiative, consideration should be given to a period of grace for penalties.

Personal Services Income and standard deduction

The discussion paper makes a general reference to Personal Services Income and suggests further consideration of the interaction of the standard deduction with the personal service income tax regime. In particular, the advice is that under *section 85 10 of the Income Tax Assessment Act 1997* (ITAA97) a non-employee with personal services income cannot deduct an amount to the extent that it relates to gaining or producing personal services income if an employee could not deduct that amount.

The *Income Tax Assessment Act 1997* Section 85 10 also states⁹:

Subsection (1) does not stop you deducting an amount to the extent that it relates to a) gaining work; or (b) insuring against loss of your income or your income earning capacity; or (c) insuring against liability arising from your acts or omissions in the course of earning income; etc.

Information to taxpayers who have PSI income needs to be clearly defined so that a fair and reasonable choice can be made concerning the election they make.

Other non-work related deductions–

As outlined in the discussion paper, it is proposed that taxpayers would not need to make an election to claim the standard deduction. Instead, the standard deduction would be automatically provided to a taxpayer who does not fill out the labels on the tax return for WRE and costs of managing tax affairs.

However, to avoid possible confusion for taxpayers who may feel that they also need to specify their claim for \$500/\$1000 by writing this amount in Income Tax Return labels D1-D6 and or D10, consideration should be given to offering the taxpayer the opportunity to elect to receive the standard deduction at the beginning of this section.

As a result of the Anstis¹⁰ case, the ATO recently issued instructions to full-time students on Youth Allowance who can now claim a deduction for their study expenses¹¹. The instructions advise that eligible taxpayers will receive a standard deduction of \$550¹² for relevant years back to the 2007¹³. The ATO has decided to automatically amend relevant assessments to include the deductions with no further action required by taxpayers. Some thought should be given to applying the ‘standard deduction’ concept to education expenses.

⁸ What work-related expenses can I claim in my 2010 tax return?

<http://www.ato.gov.au/corporate/content.asp?doc=/content/00244269.htm>

⁹ *Income Tax Assessment Act 1997*. Chapter 2 - liability rules of general application. Part 2-42 - personal services income - Division 85 - Deductions relating to personal services income.

¹⁰ Commissioner of Taxation v Anstis [2010] HCA 40 (11 November 2010)

¹¹ Study expenses changes for full-time students receiving Youth Allowance Published 7 Mar 2011

<http://www.ato.gov.au/individuals/content.asp?doc=/content/00263565.htm>

¹² The \$550 deduction amount is based on information published by academic institutions of the average amount of study expenses of \$800 – ATO Media Release 2010/44 17 Dec 2010.

¹³ Subject to specific qualifications

The return form design should also ensure that other deductions not included in the standard deduction (eg D7 Interest deductions, D8 Dividend deductions and D9 Gifts or donations) should be separated out from the standard deduction items so that it is clear and obvious to taxpayers that these items are not included and that different record keeping arrangements apply. These could also be further disassociated by marking them as “Other” or “Non-work related”

SUMMARY

The ATO has significant experience in the introduction of new legislation and new measures however the lessons of the past are lost if in the implementation policy and procedures are not clear and concise and every opportunity to remove taxpayer confusion, explored.

The potential benefits to taxpayers from the proposed standard deduction should be balanced with the need for strong process and procedures and an equally robust communication regime.

Our office would welcome the opportunity to discuss our comments relating to the optional standard deduction for WRE and the cost of managing tax affairs.