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Board of Taxation
The Treasury
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Submission to Board - Re Tax Value Method

Background

The writer is partner of a 3 partner accounting firm located in Canberra. We lodge around 3000 tax returns per annum, including over 500 business tax returns. We have around 20 staff and a turnover of nearly \$2M. Our clients include a very wide variety of businesses, investors, and personal tax return clients.

Familiarity with Tax Value Method (TVM)

The writer has attended:

- One workshop on the TVM
- One speech from Dick Warburton at the TIA conference; and
- One workshop session during the TIA conference

The writer has also read some of the publicly available material on the TVM as released by the Board, and endeavored to apply it to a small client.

Finally, the writer was interviewed about the compliance costs of introducing the TVM by the ATAX people.

The writer does not purport to be anything other than a TVM novice.

Perceived Advantages of the TVM

- The elimination or reduction of "black hole" expenditures will be advantageous, always assuming these are not re-incarnated as an "Upwards Adjustment".
- The conceptual approach appears to have superficial merit.

Disadvantages of TVM

It is foolishly simple to promote any form of words as being a solution to the interpretive problems of the current words of the 1936 and 1997 Tax Acts. The words of the Tax Acts will always lend themselves to interpretation in marginal cases. English is a very imprecise language!

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- Definitions of “assets” and “liabilities” will inevitably lead to interpretive issues. Expenditure on intangibles (eg establishment of a web site) and other in-house developmental costs (eg expenditure on writing software to support an in-house process) will continue to lead to difficulties just as it does now.

Expenditure on repairs or improvements will continue to create difficulties just as it does now.

Accordingly, the old revenue v capital dichotomy will continue to be troublesome, just as it is under current law.

- Private Use Adjustments will continue to create complexity, allocation and apportionment issues, and will continue to be troublesome, just as it is under current law. However, the TVM submerges this to an even less accessible level than the present as it is even less clearly identified.
- Linkages to other sections of the Tax Act will continue to create issues that will be troublesome, just as it is under current law. The two categories called “Upwards Adjustments” and “Downwards Adjustments” will be the starting point for a lengthy exploration of exceptions, filters, thresholds, conditions, stipulations and anti avoidance requirements. The current law contains all of these in multitudes; the TVM will still have much of this.

The compliance costs inherent in the current Tax Acts are compounded many times over by the interplay of these links. There is little suggestion that the TVM will do away with any of these links. However, it will change and revise them all, at immense transitional costs.

Compliance Costs of TVM

- Only academics, lawyers, accountants and a small number of public servants read the Tax Acts. Any simplification, change to wordings, formulae or processes will be read by a ridiculously small population.
- The impacts of changes to the Tax Acts can be felt by a far larger population, especially where there is a change to tax policy or tax rates.
- The TVM is not intended to have any significant change to tax policy or tax rates. It is essentially a change to concepts, semantics, formulae and approach, all to achieve the **same outcome**.
- Accordingly the vast bulk of small businesses, who want to know the outcome but are not particularly interested in the process nor formula or conceptual approach, will be largely disinterested in any change. Small business views much of this as a compliance cost, to be managed in the shortest, simplest manner possible.
- Small businesses do not “value” compliance work as it usually yields little or no additional profit or wealth, but does cost in time and fees for professional advisers.
- It follows from the above points that a change to the process of calculating taxable income that yields little or no change compared to the current process will not be valued by small business.
- It further follows that any additional fees and charges attempted to be levied by professional advisers in implementing this change will not be favorably met.

In short, the appetite of small business for further and additional accounting costs is finite. It is also already at or close to the limit in relation to compliance costs.

Under-Recognition of the Role of Tax Agents

- Tax agents lodge almost all business tax returns, in addition to lodging the majority of personal tax returns.
- Businesses, especially small business, rely heavily on their tax agent for information about changes to tax law that impact upon them.
- Tax agents form a crucial link between tax law, the Australian Taxation Office, and tax payers.
- Tax agents will have to change at least the following if the TVM is adopted:
 - ❑ Standard work papers
 - ❑ Software (and probably hardware upgrades)
 - ❑ Staff training for professional staff
 - ❑ Interview checklists
 - ❑ Completion checklists
 - ❑ Review and QA procedures
 - ❑ Staff training for support staff
 - ❑ Precedents and procedures
 - ❑ and many more.

Tax agents will suffer substantial training costs, lost time, and business reinvention time. This must result in higher costs. Clients will not have the appetite or the desire to pay. Remember - these are compliance costs that add no value and achieve only minor or no change in the tax outcome.

Clients will not pay for the higher costs.

- Tax agents will thus have to bear the costs - and this industry is not that profitable!

If the TVM is implemented to cure the ills of the existing tax act, the tax agent community - the link between tax laws and the community, will be squeezed beyond its ability to cope. The outcome could well be "operation successful - patient dead".

Nb: The above analogy should not be interpreted as implying that tax agents are the sick patient!

Conclusion

Against the background of the TVM being a change to a compliance process, and thus not valued by small business; and a tax agent community that is the most important link and sometimes the only link between tax law, the Australian Taxation Office and the business community, can it be said that the future benefits outweigh the transitional and on-going cost?

The perceived advantages are both miniscule and widely distributed compared to the costs, which are very narrowly focused and very, very substantial.

All to effect a change to semantics, formulae and a conceptual approach, with no substantive change in policy outcome.

An operation to cure a mildly debilitating ailment that kills the patient but cures the ailment cannot be said to be a change to the better! This is the unacceptable risk that implementing the TVM takes. The result: "Operation successful - Patient Dead" is not a desirable outcome.

The Alternatives

The Board of Taxation has poured significant resources into exploring the TVM. Some of the lessons learned and conceptual approaches can and should be brought into the existing Tax Acts.

For example, the elimination of "black hole" expenditure could be made by changes to the existing tax laws.

Whilst this "incremental change" is less ideal than a "big bang" operation, it may not kill the patient in the process!

Yours faithfully
Everall Merrett Mann DFK Pty Ltd

A handwritten signature in black ink, appearing to read 'R. Shelton', with a long horizontal line extending to the right.

Robert Shelton CPA B Comm M Tax FTIA
Director