Software Developers Consultative Group (SDCG)

Tax Value Method Submission

Submission from the SDCG to the Board of Taxation on the Tax Value Method and its impact on software developers.

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Contents

1. Outline

This document outlines submissions from the Software Developers Consultative Group (SDCG) to the Board of Taxation on the proposal to introduce Tax Value Method (TVM).

It outlines the SDCG's key concerns and recommendations in relation to TVM, should TVM be pursued and implemented.

The SDCG neither actively supports nor objects to the introduction of TVM.

The SDCG can see positive and negative reasons for introduction and non-introduction of TVM. The SDCG recognises on the basis of information available to date that:

1. the introduction of TVM is likely to lead to some cost to sections of our member base that develop accounting software; and
2. the introduction of TVM is likely to lead to **significant** cost to sections of our member base that develop tax preparation software.

It should be noted that the SDCG, being focussed on representing the interests of software developers, does not see itself as being in a position to comment on tax law policy changes.

The SDCG commends the ATO and the Board for its approach to date on the co-operative and open stance to reviewing TVM and the effect on the Australian community.

2. Key Submissions

1. The introduction of TVM will have a significant impact on software developers that produce tax return preparation software.
2. There is a need for early certainty and co-design on the ATO filing requirements under TVM.
3. Until the lodgement details are finalised, it is not possible to accurately determine the effect of TVM on general accounting software and other vertical market software such as investment calculators
4. There should be minimal recurring changes across the next 3-4 years leading up to the introduction of TVM.
5. A single TVM calculation method should be selected from the possible calculation approaches. The SDCG, whilst having limited opportunity to review the possible approaches, believes that the profit and loss reconciliation method appears most appropriate to implement.
6. TVM be considered as a platform to introduce non-mandatory adjustment worksheets behind the calculation approach to demonstrate how records could be kept. These must be consistent with flexibility under the ATO's Co-operative Compliance Review process.
7. The requirement for detailed disclosure in the "Adjustments" section of the TFM formula should be minimised.
8. The preferred method of introduction of TVM is for evolution of the legislation over time, with a "big bang" commencement of the law.
9. The production of a "gap analysis" product facilitating identification of necessary software changes, specifically with regard to consistency issues across the legislation.

3. Context of the Submission

The SDCG was informed of the potential introduction of TVM through regular SDCG forums.

With around 80% of income tax returns being returned to the ATO by electronic means, the SDCG understands the concerns of the Australian taxpaying community from an electronic communication perspective. The SDCG therefore recommended that a separate sub-committee of the SDCG be established to consider the potential impact of TVM on software developers and taxpayers. It was requested that the ATO attend the TVM sub-committee to provide detail on the possible operation of TVM.

The sub-committee subsequently met on Thursday 4 April and Thursday 18 April 2002 to consider the operation of TVM, and to agree upon consistent TVM issues affecting members of the SDCG.

It was concluded through these sub-committee meetings that the introduction of TVM would introduce a significant impact on tax software developers (being those members that produce software which automate part or all of the tax return preparation process).

The submissions outlined in this document were raised during these meetings and formalised subsequent to the meetings. This submission document was then made available for SDCG member comment, with comments being included in this final document.

It should be noted that the SDCG have focussed on the practical application of the proposed TVM approach in producing information required by taxpayers and the ATO alike. The focus on policy or other issues has therefore been limited.

3.1. Key issues considered by the SDCG

The key issues considered by the SDCG were:

- Impact on software
- The new lodgement form(s)
- Prior year losses and the carry-forward and offset process under TVM
- Issues from Tax Agent workshops
- Integration with consolidations and the Simplified Tax System
- Accountants' working papers
- Adjustments - definition
- Preferred calculation method
- Impact on software developers as reported under the "TVM Information Paper" released by the Board

- Potential Implementation process
- Co-operative compliance process
- Credits/rebates under TVM
- Information sources re policy changes

These issues are detailed in the minutes to the SDCG meetings and can be found on the SDCG website at http://202.174.232.41/sdcg/sdcg_about.asp.

3.2. Breadth of SDCG impact

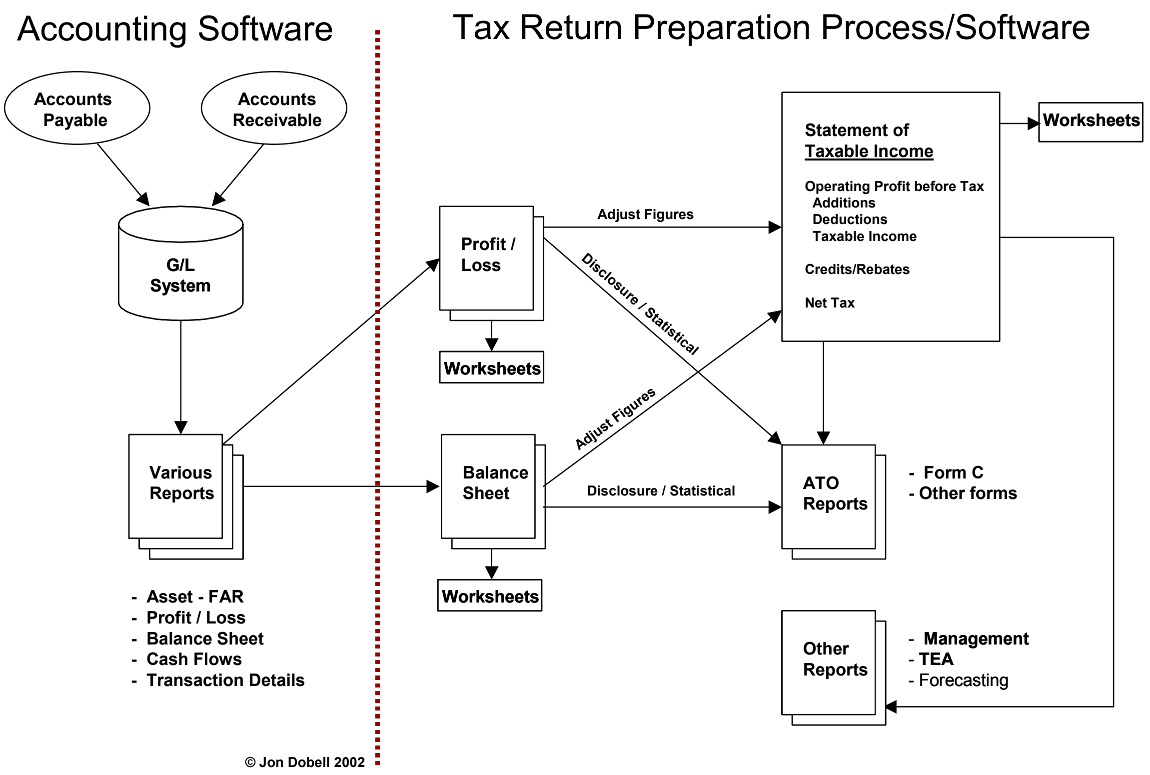
As an indication of the number of Australian taxpayers who use products developed by members of the SDCG, the following table outlines income tax return filings to the ATO across the last three years.

Years ended	30 June 1999	30 June 2000	30 June 2001 (filed up until 12 April 2002)
ELS filings	8,000,000	12,000,000	13,262,764
Taxpack Express	280,000	235,000	199,033
eTax	27,000	117,000	279,255
Phone Lodgements	n/a	n/a	14,227
Paper Lodgements	2,000,000	2,000,000	2,035,290
Total Lodgements	**10,307,000**	**14,352,000**	**15,790,569**
Total Electronic Lodgements	8,307,000	12,352,000	13,741,052
Electronic Lodgements (%)	**80.6%**	**86.1%**	**87.0%**

- ELS is a process whereby income tax returns may be filed electronically with the ATO by tax agents. The majority of ELS taxpayers utilise products developed by members of the SDCG.
- Actual usage of tax preparation software may in fact be higher than the figures above indicate. A number of paper lodgements are also prepared on tax preparation software that does not have an ELS module integrated within it. For example, many companies utilise tax preparation software packages developed by the large accounting firms which, until recently, have not included electronic lodgement capability.

3.3. Tax Return Preparation Process

The SDCG considered the issues outlined above in the context of a "standard income tax return preparation process". This process is outlined in detail following.



The left hand side of the diagram above details **"accounting software"** in the broadest sense – software that allows businesses to produce normal accounting information and requirements. The right hand side of the diagram details the process adopted in **"tax return preparation process/software"** – the process or software that allows businesses to prepare in an automated or semi-automated fashion the ATO's reporting and filing requirements.

3.4. TVM Information Paper Comments

Pages 44 and 45 of the "Tax Value Method Information Paper" released by the Board of Taxation on 6 March 2002 contain specific comments on the anticipated impact of TVM on software developers.

These pages focus on the accounting software used by business taxpayers.

As outlined above, the SDCG believes that, based on the information available to date, the likely impact on pure accounting software will be minimal. In contrast, however, the likely impact on tax preparation software will be significant. This is detailed further below.

In considering the current worksheet options, page 44 of the Information Paper contains the statement " For business taxpayers to calculate taxable income, initial feedback from the accounting software developers is that the methodologies behind the worksheets could be accommodated in the existing software products".

Whilst the SDCG agrees that the worksheets could be incorporated within existing accounting systems, this will require some, potentially minor, changes. For tax preparation software, where existing tax "worksheets" and calculation methodologies are already embedded in the software, such changes are likely to be much more costly.

3.5. Detail of Submission

3.5.1. The introduction of TVM will have a significant impact on software developers that produce tax return preparation software.

- "Tax return preparation software" has been developed to date providing an automated or semi-automated approach to preparing the ATO income tax return reporting requirements.
- Although it is understood that the majority of information necessary to prepare TVM income tax returns will be available to taxpayers, the format, automation and process for collecting and collating this information will change.
- This will lead to significant transitional cost to those software developers that have invested in developing software designed to support the ATO's current reporting requirements.
- It will also lead to significant impact on medium to large corporates who may have implemented their own automated, or semi-automated approach to preparing corporate income tax returns.
- This cost should be taken into account in considering the benefits and detriments to the introduction of TVM.

3.5.2. There is a need for early certainty and co-design on the ATO filing requirements under TVM.

- Software developers generally work toward a set of requirements or specifications in order to deliver a required business outcome.
- At this stage in the TVM debate, there is no "format" or "standard" proposed for the "look and feel" of the required TVM filing requirements.

- On this basis, it is difficult for the SDCG to quantify the precise change likely from the introduction of TVM.
- In addition, software development generally requires a significant lead time to implement changes to software. A degree of certainty is therefore required on the format of the forms significantly in advance of any proposed commencement date.
- Further, given the direct expense which would be incurred by SDCG members for complying with proposed TVM reporting changes, any proposed changes should only be made in consultation or co-design with the SDCG.

3.5.3. Effect on general accounting software packages and vertical market software packages

- Until the format of the lodgement forms is decided the effect on general accounting software cannot be accurately quantified, but it appears that some changes in database structure and reporting will be required for these products
- These changes in data base structure may be necessary in order to ensure that "standard" accounting data captured can be efficiently transferred from "accounting packages" to "tax preparation packages". Of particular significance will be the training required and, therefore significant cost for operators of such accounting systems to understand how accounts/transactions should be flagged for TVM purposes. This "hidden" training cost will be across the broad spectrum of Australian taxpayers.
- Some vertical market software, such as investment calculators and forecasters, may also be affected by inadvertent policy changes caused by standardisation of the legislation

3.5.4. Minimal recurring changes across the next 3-4 years leading up to the introduction of TVM.

- Given recent changes to tax law, including the introduction of the GST, software developers have borne a significant degree of change in providing taxpayers with mechanisms to comply with legislative requirements.
- The current introduction of the income tax consolidation measures for companies and the requirements of Accounting Standard AASB 1020 dealing with tax effect accounting, are bringing further pressures on software developers to modify existing software to comply with these requirements.
- At this stage, it appears that the corporate income tax filing requirement for 2003 will include changes for the new consolidation measures. It also appears possible that additional changes may be made in the 2004 year to “simplify” these consolidation reporting requirements.

- If TVM were then introduced in 2005, this would give an unbroken period of approximately 7 –10 years where software developers have borne significant expense and time to modify products for significant tax changes.
- Changes for the reporting requirements for TVM if introduced should therefore be minimised.

3.5.5. A single TVM calculation method should be selected from the possible calculation approaches. The SDCG, whilst having limited opportunity to review the possible approaches, believes that the profit and loss reconciliation method appears most appropriate to implement.

- Experience of the SDCG members has been that when multiple calculation options are available for specific purposes, each and all of these are expected to be reproduced in commercially available software.
- This is the cause of significant resource consumption in a resource constrained area.
- Providing the choice of multiple calculation methods can also lead to taxpayer “confusion” as to which method is appropriate for their circumstances. The choice of multiple methods can therefore cause a lowering of integrity from a compliance perspective.
- In addition, the choice of multiple methods is likely to lead to the ATO encountering difficulties when reviewing taxpayer information. Direct comparatives may be difficult to make, requiring taxpayers to justify or explain their specific calculations.
- Although having only limited opportunity for review, on the basis of the current proposed methods, the SDCG believes that the profit and loss reconciliation approach would be the most appropriate method to build into existing tax software. It relies on concepts and terminology with which taxpayers are already familiar, and is therefore likely to lead to less confusion.

3.5.6. TVM could be considered as a platform to introduce non-mandatory adjustment worksheets behind the calculation approach to demonstrate how records could be kept. These must be consistent with flexibility under the ATO’s Co-operative Compliance Review process.

- Tax adjustment workpapers are currently non-standardised across taxpayers (large, small, individual, corporate etc). For the larger taxpayers, where multiple tax adjustments are often required between the accounting numbers and the tax numbers, these worksheets are often built up on an ad-hoc basis over time.

- For a large number of taxpayers who were around prior to the introduction of self-assessment in the early 1990's, the existing adjustment worksheets reflect these earlier requirements as to the type of information previously filed with the ATO. Taxpayers have carried these forward into the self-assessment regime, but simply retain the adjustment sheets on their tax file working papers.
- With a change to TVM there will be a need for taxpayers to look at changing the format and layout of their existing tax adjustment worksheets.
- In addition to the selection of a single calculation methodology, the SDCG recommends that a suite of non-mandatory adjustment worksheets be introduced to facilitate how taxpayers prepare tax calculations.
- The SDCG is mindful however that any such worksheets should be consistent with the principles of the ATO's Co-operative Compliance Review process. Specifically, that the level of expected documentation and support has a direct nexus with the risk level of the specific taxpayers. It is on this basis that we would recommend that the workpapers are non-mandatory, merely a facilitator for taxpayers.

3.5.7. The requirement for detailed disclosure in the "Adjustments" section of the TVM formula should be minimised.

- The SDCG understands that the Commissioner of Taxation has a degree of discretion in determining the form, substance and requirements of the annual income tax return forms.
- Nevertheless, the SDCG also understands that the Commissioner of Taxation utilises the annual return form process, particularly for corporate taxpayers, to collect statistical information for the Australian Bureau of Statistics.
- The collection of the current statistical information required is a cumbersome and costly process to medium and large taxpayers who may have many sources of information to consult in order to calculate the disclosures required.
- The current annual returns also require taxpayers to identify specific addbacks and deductions on the return form. The degree and number of items required for disclosure as addbacks and deductions has been increasing steadily over recent years.
- This increase in the number of items required for disclosure leads to significant rework for tax software producers, as it requires a specific reconciliation from the reported return form data to the underlying source information.

- The SDCG questions the extent to which the disclosure is put to use by the Commissioner of Taxation in performing his role of assessing taxpayers.
- The SDCG recommends that the degree of disclosure for specific addback and disclosure items under TVM be minimised. The introduction of non-mandatory adjustment worksheets would go some way toward alleviating any potential concern regarding information integrity through minimising reporting.

3.5.8. The preferred method of introduction of TVM is for evolution of the legislation over time, with a "big bang" commencement of the law.

- The SDCG understands there are three possible methods by which TVM may be introduced.
- An approach whereby changes are legislated, enacted and commence operation over time (a "drip feed" approach) is not favoured by the SDCG. This approach is likely to cause a drawn out, repetitive software redevelopment/upgrade process over a number of years. This is a highly expensive process, requiring multiple and repetitive testing scenarios. In addition, it also increases the likelihood of difficulty integrating the various updated components within the underlying software.
- An approach whereby all TVM changes are legislated, enacted and commence operation at a specific point in time (the "big bang" approach) would be preferable to a drip feed approach. This would allow all required changes to be developed and tested at a single point in time, therefore increasing efficiency. The SDCG does however have a concern that insufficient lead time may be available to undertake such a redevelopment exercise.
- The SDCG therefore sees a compromise solution of evolving legislation over time, with a single commencement date at a future point in time, as being a preferable outcome. This provides the detail on likely changes as early in time as possible, and allows for a staged development process without a repetition of testing scenarios. It eliminates the need for dual systems under a "drip feed" approach, and also mitigates the risk of insufficient time under the "big bang" approach.

3.5.9. The production of a "gap analysis" product facilitating identification of necessary software changes, specifically with regard to consistency issues across the legislation.

- Under TVM, it appears that one of the drivers for change is consistency across the legislation. It is therefore expected, for example, that rules surrounding issues such as timing of disposal of assets for trading stock, CGT and other purposes will be made common.

- The creation of these "common rules" will remove the differentials under the current law. In many instances, such as for disposal dates, these differentials are automated under tax preparation software (particularly in relation to acquisition and disposal of assets).
- The SDCG therefore requests that as part of any TVM introduction process, "gap analysis" products be released which show where these changes occur. This will facilitate software developers in ensuring their products can be modified to adequately deal with such changes.

4. Background on the SDCG

The Software Developers Consultative Group was established in October 1999 from a wide range of businesses.

It comprises representatives of the business software industry and the group has agreed upon the following (if viewing this document online, click on the item to link to the ATO's Registered Software Facility and read the specific pages):

- The SDCG Member Contact List for 2002
- Member Entities for 2002
- Selection Process for 2002
- Code of Ethics
- Group Operating Policies
- Meeting Schedule
- Mission Statement
- Roles and Responsibilities

The Mission Statement and Roles and Responsibilities of the group are reproduced below for ease of reference

4.1. Mission Statement

To be a forum for communication between software developers and the ATO to:

- provide the ATO with a sounding board for initiatives relating to the development of software to support ATO requirements, and
- give industry a vehicle to provide feedback to the ATO.

To oversight the operation of the software registration process.

4.2. Roles and Responsibilities

The Software Developers Consultative Group does:

- Develop, maintain and monitor a code of ethics, including standards of conduct for group members
- Develop, maintain and review the operation of the product registration model, including requirements for the testing and registration processes
- Review ATO material such as specifications, taking into account industry feedback
- Provide input into guidelines for the presentation, including structure and format, of specifications and other material used by software developers

- Develop a process for identifying, documenting and addressing, in a timely fashion, issues and questions that software developers may raise
- Provide a forum to present feedback from customers to the ATO
- Provide, or identify resources who can provide, specialist advice on software development issues to areas within ATO

The Software Developers Consultative Group does not:

- Develop specifications - this is the responsibility of the ATO
- Manage the day-to-day operations of the software registration process - this is the responsibility of the ATO

5. SDCG Members

The SDCG Member Contact List for 2002

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