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e-filing and compliance risk: Evidence from Australian personal income tax deductions

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ABSTRACT

Two major advances in personal income tax administration over recent decades are the pre-filing of tax returns and the electronic lodgement of those returns. However, pre-filing has been largely restricted to income and information reported in previous years, not current year costs incurred in generating taxable income (or deductions). This has not constrained national revenue bodies from putting in place incentives for greater take-up of e-filing as in the case of Australia where with electronically filed personal tax returns, the ATO has a general commitment to make any refunds in 12 days or less while with paper returns, it is 50 days. What has not been adequately investigated is whether incentivising e-filing by self-preparers, at a time when prefilling is focussed mostly on income with less on deductions, poses a potential compliance risk. This paper investigates this issue in the case of the Australian personal income taxpayers over the period 2003-04 to 2012-13 and whether there is a distinct change in the deductions claim behaviour of those self-preparers lodging electronically via *e-tax* compared to those lodging paper returns or via tax agents. The paper finds that over the 10 year period studied there were distinct changes in the work-related expense deduction claims behaviour of self-preparers relative to those using a tax agent, with *e-tax* self-preparers having a significantly increased incidence of claims, even though the average level of relative claim declined. In an environment with incentives for electronic lodgement and limited prefilling of deductions, it is concluded that this differential behaviour warrants further study from both a compliance risk perspective as well as the appropriateness of the current policy treatment of deductions.

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1 THE ISSUE

Considerable attention has been given to the benefits of e-filing by personal income taxpayers and to pre-filing of returns by revenue bodies with information they already hold on those taxpayers or have collected from third parties. As the OECD (2015, p16 and Box 1) observed, by 2013 over 95% of OECD countries had electronic filing systems and over two-thirds of their revenue bodies achieved e-filing usage for over 75% of their personal income and corporate taxes and for VAT/GST.

For taxpayers, an advantage of e-filing is that it is free and typically, that the revenue body is committed to providing refunds much faster than with paper returns¹. In the Australian case, the Australian Taxation Office (ATO) is committed to making refunds on e-filed tax returns within 12 business days but only 50 business days with paper returns.² For revenue bodies, the benefits from pre-filing are the timeliness of lodgements, improved compliance and data integrity, and the releasing of revenue staff to better focus resources on those taxpayers where income prefilling is incomplete (or even not possible) or where taxpayers are attributed a high non-compliance risk-rating.

While pre-filing typically includes income-related information from employers, government bodies, financial institutions (interest income) and companies (dividend income), it rarely extends to all deductions. The reason for this is largely because third parties cannot readily attribute expenditure to individuals let alone whether this expenditure is tax deductible. In response, revenue bodies are attempting to facilitate individuals to pre-fill their deductions through enabling taxpayers to record in real time their deductions in advance of them being claimed. In the case of the ATO, this has seen the development of the *myDeductions* app as a complement to *myTax*, enabling income deductions to be recorded on mobile devices.³ In the Nordic countries, the solution has been to limit access to deductions and where they are available, to those where (actual or supporting) data can be supplied from third parties.⁴

This has led some⁵ who endorse a more widespread and rapid application of pre-filing to investigate the scope for limiting access to personal income tax deductions. However, any move to limit income-earning related deductions involves a separate debate to pre-filing which goes to the purpose of

¹ For a discussion of personal income tax e-filing in Australia, Belgium, California, Québec, and Spain, see Vaillancourt(2011).

² See <https://www.ato.gov.au/Individuals/Lodging-your-tax-return/Lodge-a-paper-tax-return/>
<https://www.ato.gov.au/Individuals/Lodging-your-tax-return/Lodge-online/> <https://www.ato.gov.au/Individuals/Lodging-your-tax-return/In-detail/Pre-fill-availability/>

³ See <https://www.ato.gov.au/general/online-services/in-detail/transact-online/mydeductions/mydeductions/> .

In the ATO Annual Report 2014-15 (Volume 1, p12) it was stated that the ATO would use the information recorded in *myDeductions* for 2014-15 returns “to pre-fill their 2016 income tax return”. (see https://annualreport.ato.gov.au/sites/g/files/net376/f/AR_14-15_Vol1_n0995_js34758_w.pdf)

⁴ The range of non-income related deductions able to be pre-filled by revenue bodies from third parties includes: home mortgage interest, gifts, union fees, child care and unemployment insurance (see OECD 2006, 2008, 2010, 2012) for reference to the approach in Nordic countries). In Australia’s case, the private health insurance rebate which, while not technically a deduction is expenditure related, does attract a rebate of tax and is effectively pre-filled as is deductions data capable of being rolled-over from previous years.

⁵ Highfield(2006) found that prefilling in Nordic countries was substantially aided by limited access to a wide range of deductions while Evans (2004) and Kerr(2012) saw the availability of deductions like work-related expenses as a constraint on pre-filing designed to remove the need for taxpayers to lodge their own returns.

deductions, how they should (or should not) be structured, and to whom they should be available.⁶ Assuming that economic efficiency issues are not overwhelmed by simplicity considerations,⁷ there will continue to be a case for earnings-related deductions and difficulties in prefilling such claims and concern about the integrity of data on claimed deductions (prefilled or not). Even if there was a widespread take-up of mobile devices to record deductions in real time as with the ATO *myDeductions* app, or more importantly, the provision by third parties of information on individual taxpayer's deductible expenses, the revenue body will continue to have an issue with the data integrity as the split between what is 'private, domestic or capital' in nature and what is income-related expenses, will not always be clear.

Where this risk manifests itself most significantly is when taxpayers react positively – but creatively – to the promise of a rapid-processing of e-filed returns. Through pre-filled and e-filed returns, the ATO for example assures those taxpayers with simple returns that they can complete their return in “20 minutes”⁸ and that they can generally have any refund in “12 business days or less”. This expedited processing of returns raises two important issues: firstly, will taxpayers not report income not-prefilled on their tax return at the time of lodging and secondly, will they over-claim deductions because they know there is no third party information on it supplied to the revenue body.

In relation to the non-reporting of income not pre-filled, this is unlikely to be an issue. In the Nordic countries it is common for third-parties to be required to lodge taxpayer data within one month. In practice in many countries, it might take much longer and may not occur for some weeks (or even months) after the end of the financial year. However, while any prefilling in the interim will therefore be incomplete and early lodged returns will need post-assessment income matching when the full range of data is available, taxpayers would know that ultimately automated matching would reveal any mismatch at minimal administrative cost and so have every reason to include missing income data.

This is not the case with data on deductions as taxpayers would know that there is little third party information on them supplied to the revenue body and that small claims would not be cost effective for the body to pursue even if it identifies non-standard deduction claims behaviour. Moreover, if this non-compliance became systematic through a perception that detection is not occurring, then otherwise non-standard behaviour could become standard and over claiming, systematic, making automated detection of non-compliance difficult.

This issue is understood and the literature on how prefilling can reduce taxpayer compliance costs and non-compliance gives particular attention to minimising access to available deductions.⁹ Also, by removing deductions which cannot be prefilled, there is more scope to transition from pre-filing to automated lodgement with the taxpayer's role being reduced to that of reviewing not completing returns. However while abolishing deductions might be attractive from a simplicity perspective in facilitating full pre-filing and automated lodgement, it is not necessarily acceptable from an

⁶ These issues are currently under review in Australia by the Australian Parliament House of Representatives Standing Committee on Economics Inquiry into Tax Deductibility (http://www.aph.gov.au/Parliamentary_Business/Committees/House/Economics/Tax_deductibility)

⁷ While equity considerations are relevant to any consideration of deductions, the focus here would be on issues such as caps and offsets rather than elimination of access to such deductions.

⁸ See <https://www.ato.gov.au/Individuals/Lodging-your-tax-return/In-detail/Transcripts/Video-transcript---The-benefits-of-lodging-with-myTax/>

⁹ See Evans and Tran-Nam (2010). OECD(2010, 2015), Vaillancourt(2011)

economic efficiency, equity or political¹⁰ perspective. Some deductions are therefore inevitable even if this conflicts with achieving simplicity and facilitating prefilling. While deduction design can (as further discussed in Section 4) ameliorate such conflicts, just what those conflicts are and how they arise is a necessary precursor to any redesign to address design deficiencies. If for example, pre-filing income but not deductions on e-filed returns can be shown to be a compliance risk for a revenue body, then some support could be found for changes to the administration of deduction claims and to policy design so as to minimise non-compliance.

Box 1 e-Filing in OECD Countries

All major taxes

- Over two-thirds of revenue bodies in OECD countries achieved e-filing usage for over three-quarters (75%) of their PIT, CIT, and VAT taxpayers in 2013.

Personal income tax

- The provision of e-filing services for the PIT is now just about universal across the countries surveyed, with all countries where the national revenue body administers a PIT reporting the availability of this service for fiscal year 2013.
- Almost 60% of revenue bodies reported that the majority of their personal taxpayers filing returns used e-filing (either by themselves or via tax professionals) for the 2013 year:
 - Twenty-nine of fifty reported usage rates in excess of 75%;
 - Four of fifty reported usage rates between 50-75%;
 - Four of fifty reported usage rates between 25-50%;
 - Thirteen of fifty reported usage rates less than 25%; and
 - For six countries relevant data were not available.
- A number of countries have made substantial progress (i.e. +75% in absolute terms) over the last 10 years in increasing their e-filing usage-Argentina (+82%), Israel (+95%), Lithuania (+82%), Slovenia (+100%), South Africa (+95%).
- Drawing on the information in Table 9.8, revenue bodies generally have not relied on the use of mandated e-filing requirements to achieve high rates of e-filing take up for PIT taxpayers.
- There is potential for substantially greater use (i.e. +75% in absolute terms) of e-filing in 25% of countries surveyed, including in four OECD member countries-Czech Republic, Hungary, Luxembourg and Slovak Republic

Source: OECD (2015) p250

The focus of this paper is therefore on the important question of whether evidence can be found for e-filing changing taxpayer deduction claims behaviour and therefore poses a compliance risk in the form of disproportionately higher incidence and levels of deductions being claimed in their e-filed returns. Evidence will be sought from differential trends in selected personal income tax deductions in Australia since the introduction of e-filing for self-preparers in 1998-99, focusing on claims by those lodging with tax agents or who were self-preparers but either lodged electronically or with paper.

Section 2 begins with a brief overview of Australia's history of e-filing and pre-filing. Section 3 utilises the annual Australian personal income taxpayer sample files for the period 2003-04 to 2012-13 to examine whether there is evidence of a disproportionate unexplained relative growth in the number and level of deductions by those lodging self-prepared e-filed and paper returns, and those whose returns are prepared by tax agents.

¹⁰ In the Australian context, the availability of numerous deductions has led to political sensitivity about any action designed to remove those deductions which result in a tax refund, as many individuals budget around receiving this refund.

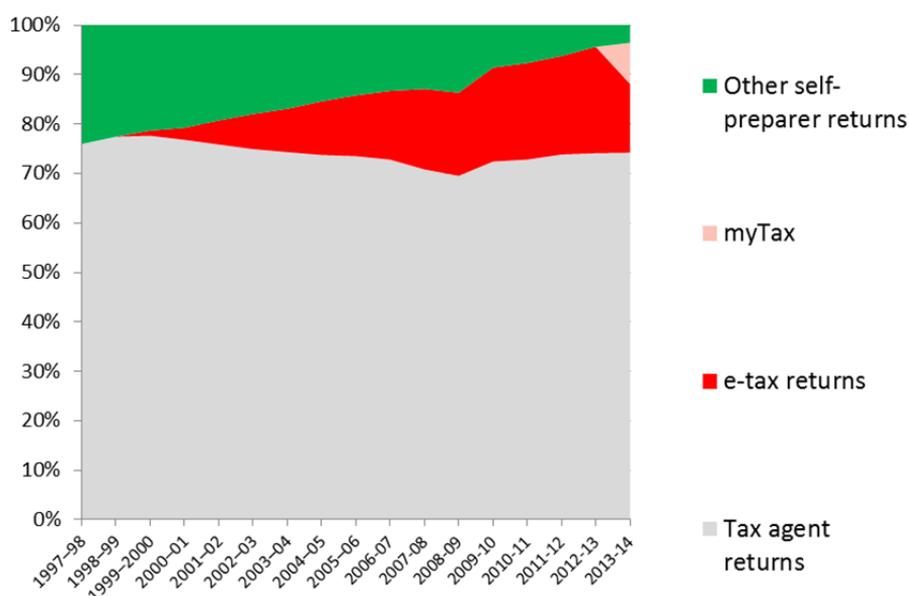
While preliminary analysis of the data shows that there is evidence in the Australian case of some unexplained differences in the trend behaviour of deduction claims by taxpayers with and without tax agents, there is also a marked difference in the behaviour of self-preparers depending on whether they are lodging by paper or electronically.

Section 4 examines the three important conclusions these findings raise for tax administrators and tax policy advisors. Firstly, the need for further detailed study into the underlying reasons for this disproportionate increase in deductions relative to the taxable income of self-preparers. This could include the use of longitudinal taxpayer (or panel) data to track changed behaviour. Secondly, as part of this investigation and as an interim integrity measure, self-preparers must be subject to greater audit effort, especially e-filers. Thirdly, a renewed focus must be given to the policy design of current deduction arrangements to ensure there are no unexpected behavioural consequences or compliance and therefore revenue risks to government from e-filed returns. The paper concludes with an examination of the alternative policy design options available to government in an environment where data matching or pre-filing deductions in e-filed returns is not an option and audit effort is not cost effective.

2 AUSTRALIA'S HISTORY WITH E-FILED RETURNS AND PRE-FILLING

The Federal Income Tax Assessment Act was introduced in 1915 but it was not until 1944 that the pay-as-you-earn (PAYE) tax system was adopted for employers and in 1986, that self-assessment was introduced for tax payers. While computers were introduced into the ATO in 1965, the Electronic Lodgment System (ELS) for tax agents was not trialled until 1987 (Edmonds 2010) and was only operationalised from June 1990 for 1989-90 tax returns by tax agents. It was also not until 1999 that there was a pilot across 27,000 tax self-preparers of an electronic version of the ATO *Taxpack* called *e-tax*. While *e-tax* was introduced nationally in 1999-2000, it was not available for Mac computer users until 2012-13. As shown in Table 1 (and Figure 1), the take-up of *e-tax* was initially low but by 2012-13 accounted for 84% of all lodgements from self-preparers.

Figure 1 Trend in method of Lodgement: 1998-99 to 2013-14



Source: Table 1 at <http://data.gov.au/dataset/25e81c18-2083-4abe-81b6-0f530053c63f/resource/3cd6dee1-785f-4876-a282-ebcf00f9949a/download/Taxstats2014Individual01SelectedItemsByYear.xlsx>

Table 1 Personal income payers by Lodgement method: 1998-99 to 2013-14¹¹

Year	Number of individuals		Tax agent returns		e-tax returns		myTax		Other self-preparer returns		All Self-preparer returns	
	m	m	m	%	m	%	m	%	m	%	m	%
1998-99	10.365	8.485	8.028	77.5	0.027	0.3	0	-	2.337	22.5	2.364	22.8
1999-2000	10.751	9.074	8.347	77.6	0.112	1.0	0	-	2.293	21.3	2.404	22.4
2000-01	10.933	8.948	8.397	76.8	0.266	2.4	0	-	2.270	20.8	2.536	23.2
2001-02	11.094	9.064	8.417	75.9	0.539	4.9	0	-	2.138	19.3	2.677	24.1
2002-03	11.350	9.242	8.507	74.9	0.802	7.1	0	-	2.042	18.0	2.844	25.1
2003-04	11.663	9.443	8.669	74.3	1.021	8.8	0	-	1.973	16.9	2.994	25.7
2004-05	11.946	9.723	8.811	73.8	1.295	10.8	0	-	1.840	15.4	3.135	26.2
2005-06	12.209	9.920	8.974	73.5	1.500	12.3	0	-	1.735	14.2	3.235	26.5
2006-07	12.563	9.850	9.147	72.8	1.746	13.9	0	-	1.670	13.3	3.415	27.2
2007-08	12.994	10.083	9.204	70.8	2.115	16.3	0	-	1.675	12.9	3.790	29.2
2008-09	12.908	9.582	8.976	69.5	2.170	16.8	0	-	1.762	13.7	3.932	30.5
2009-10	13.049	9.538	9.452	72.4	2.476	19.0	0	-	1.121	8.6	3.598	27.6
2010-11	13.275	9.816	9.668	72.8	2.591	19.5	0	-	1.017	7.7	3.607	27.2
2011-12	13.367	10.204	9.872	73.9	2.662	19.9	0	-	0.833	6.2	3.495	26.1
2012-13	13.226	9.762	9.803	74.1	2.845	21.5	0	-	0.579	4.4	3.424	25.9
2013-14	12.964	9.712	9.622	74.2	1.800	13.9	1.083	8.4	0.459	3.5	3.342	25.8
Change year on year												
1999-2000	0.387	0.589	0.320		0.085				-0.044		0.040	
2000-01	0.182	-0.126	0.050		0.154				-0.023		0.132	
2001-02	0.161	0.116	0.020		0.273				-0.133		0.141	
2002-03	0.256	0.178	0.089		0.263				-0.096		0.167	
2003-04	0.313	0.201	0.163		0.219				-0.069		0.150	
2004-05	0.283	0.280	0.142		0.274				-0.133		0.141	
2005-06	0.263	0.197	0.163		0.205				-0.105		0.100	
2006-07	0.354	-0.070	0.173		0.246				-0.065		0.181	
2007-08	0.432	0.233	0.057		0.370				0.005		0.375	
2008-09	-0.086	-0.501	-0.228		0.055				0.087		0.142	
2009-10	0.141	-0.045	0.475		0.306				-0.641		-0.334	
2010-11	0.226	0.278	0.216		0.114				-0.105		0.009	
2011-12	0.092	0.388	0.204		0.072				-0.184		-0.112	
2012-13	-0.140	-0.441	-0.069		0.183				-0.254		-0.071	
2013-14	-0.262	-0.050	-0.180		-1.045		1.083		-0.119		-0.082	

Source: Table 1 at <http://data.gov.au/dataset/25e81c18-2083-4abe-81b6-0f530053c63f/resource/3cd6dee1-785f-4876-a282-ebcf00f9949a/download/Taxstats2014Individual01SelectedItemsByYear.xlsx>

From 2013-14, electronic lodgement of tax returns was further refined with the introduction of the *myGov* account¹² where individuals could access not only their tax records but also interact with a range of other Commonwealth and State bodies such as Centrelink and Medicare. In *myGov* taxpayers had two options depending on how simple were their tax returns. If their tax returns were deemed complex such as where they had rental income or losses¹³, individuals were required to complete *e-tax* and lodge the completed return *myGov* but if their affairs were simple, they could complete *myTax* – an online version of *e-tax* – within *myGov*. Table 1 shows that 1.083m taxpayers filed through *myTax* in 2013-14.

Despite *e-tax* being introduced in 1998-99, prefilling of *e-tax* with information already available to the ATO through data matching was not piloted until 2004-05 and 2005-06, and was not fully available

¹¹ In each ATO *Taxation Statistics* release, the data for the last two years is subject to revision in the flowing year data release because of the need to take into account late filing taxpayers. This will affect the aggregate values but less so the averages. Care should therefore be taken in interpreting data for the latest two years.

¹² See <https://www.ato.gov.au/Media-centre/Media-releases/Tax-time-made-easy-with-ATO-online-services/>

¹³ For the criteria applied, see the tag “If you're not sure, you can check if you are eligible to use myTax” at <https://www.ato.gov.au/Individuals/Lodging-your-tax-return/>

until 2006-07.¹⁴ Today it is tax agents who are the biggest users of this information with tax agents being some 77% of those lodging returns electronically (Table 1). For the ATO, the primary motivation for data matching has been to uncover and reduce fraud and when combined with e-filing, to encourage better compliance and reduced compliance costs for taxpayers.¹⁵

While as previously noted, the merits of pre-filing are broadly acknowledged and well accepted, such pre-filing rarely extends to income earning related deductions because of a paucity of data on what is 'private, domestic or capital' in nature as distinct from a deductible expense incurred in generating taxable income. Exceptions are where those deductions can be pre-determined such as some minimum deduction entitlement or a fixed tax offset (Warren 2014) or those deductions which an employer (or the revenue body) have been informed of as a deductible expense when determining PAYE tax deductions such as where owner-occupied home mortgage interest is deductible (as in the United States). While data-matching might assist the revenue body to verify deductions data entered into tax returns, it cannot easily verify whether this entire claim is a legitimate expense incurred in earning taxable income which must restrict the scope for prefilling tax returns with such data.

Table 2 Personal income deduction as a % total income: Australia 1998-99 to 2013-14

	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Total Claims as % Total Income																
Total work related expenses	2.3%	2.4%	2.6%	2.8%	2.8%	2.8%	2.8%	2.8%	2.7%	2.8%	2.8%	2.8%	2.7%	2.7%	2.7%	2.7%
Cost of managing tax affairs	0.2%	0.2%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%
Gifts or donations	0.2%	0.2%	0.2%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.4%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%
Total Deductions	5.1%	4.1%	4.5%	4.8%	4.9%	5.0%	5.3%	5.8%	6.3%	5.8%	5.5%	4.9%	4.8%	4.6%	4.2%	4.3%
Rent interest deductions	1.6%	1.7%	2.0%	2.0%	2.2%	2.6%	2.9%	3.1%	3.1%	3.5%	3.4%	3.1%	3.5%	3.5%	3.1%	2.8%
Rent capital works deductions	0.1%	0.1%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.3%	0.3%	0.3%	0.3%	0.3%	0.4%
Rent other rental deductions	1.6%	1.7%	1.8%	1.9%	2.0%	2.0%	2.0%	2.0%	1.9%	1.9%	2.0%	2.1%	2.1%	2.2%	2.3%	2.4%
Rent Deductions	3.3%	3.5%	4.0%	4.1%	4.4%	4.8%	5.2%	5.3%	5.2%	5.7%	5.7%	5.5%	5.9%	6.0%	5.7%	5.5%
Claimants as a % of all individuals																
Total work related expenses	63.0%	63.7%	64.2%	62.6%	62.3%	62.6%	63.1%	63.7%	64.0%	64.9%	64.7%	64.8%	65.4%	66.3%	65.9%	66.3%
Cost of managing tax affairs	46.4%	46.4%	45.9%	45.5%	45.0%	44.4%	44.4%	44.1%	43.5%	43.4%	45.9%	45.1%	46.3%	47.3%	47.9%	47.6%
Gifts or donations	32.7%	32.3%	32.6%	33.8%	34.0%	34.4%	37.4%	35.6%	35.4%	34.9%	37.0%	34.8%	37.1%	34.9%	35.1%	35.1%
Total Deductions	80.8%	80.0%	79.5%	78.5%	78.0%	78.3%	79.3%	79.6%	79.9%	79.7%	79.9%	79.6%	80.4%	81.1%	80.7%	80.5%
Rent interest deductions	8.8%	9.2%	9.4%	9.8%	10.1%	10.5%	10.6%	10.8%	10.9%	11.0%	11.1%	11.4%	11.6%	12.1%	12.5%	12.7%
Rent capital works deductions	2.4%	2.7%	2.9%	3.3%	3.6%	4.0%	4.3%	4.5%	4.8%	4.9%	5.2%	5.6%	5.8%	6.3%	6.7%	7.1%
Rent other rental deductions	12.3%	12.6%	12.6%	12.9%	13.1%	13.3%	13.3%	13.5%	13.6%	13.6%	13.7%	14.1%	14.3%	14.8%	15.3%	15.6%
Net Rental Income	12.4%	12.7%	12.7%	13.0%	13.2%	13.5%	13.4%	13.6%	13.7%	13.7%	13.8%	14.2%	14.4%	14.9%	15.4%	15.7%

Note: Colour code is blue below the midpoint (or benchmark) across the years for a given variable and red is above with the strength of the colour change reflecting greater distance from the benchmark value

Source: Table 1 at <http://data.gov.au/dataset/25e81c18-2083-4abe-81b6-0f530053c63f/resource/3cd6dee1-785f-4876-a282-ebcf00f9949a/download/Taxstats2014Individual01SelectedItemsByYear.xlsx>

As shown in Table 2, in Australia deductible work related expenses which are not pre-filled were 2.7% of total taxpayer assessable income in 2013-14 while rental property deductions were some 5.5%. Being deductible at taxpayer's marginal tax rate which can be considerably greater than their average tax rate, the risk to revenue from deductions related non-compliance is real and significant. Table 3 highlights that since the introduction of *e-tax* in 1998-99, even though the average deduction claimed varies widely relative to income, the increase in the proportion of taxpayers making a claim is

¹⁴ See <https://www.ato.gov.au/Tax-professionals/Tax-Agent-Portal/Using-the-Tax-Agent-Portal/Portal-reports/Pre-filing-service/Pre-filing-reports-2007-2015/> and the ANAO review of data matching at http://www.anao.gov.au/uploads/documents/2007-08_Audit_Report_30.pdf

¹⁵ See <https://www.ato.gov.au/General/Building-confidence/In-detail/Data-matching/> and <https://www.ato.gov.au/general/building-confidence/in-detail/data-matching/current-data-matching-programs/>

clear with the growth in the number of claimants rising faster than taxpayer numbers. While monitoring outlier deduction claims can go some way to addressing deduction integrity concerns,¹⁶ it cannot easily address systemic non-compliance or increased take-up.

The focus of the following section is on whether:

- a) the move to e-filing and away from paper returns by self-preparers in Australia has resulted in any meaningful increased incidence and level of claims by self-preparers as against that in returns prepared by tax agents; and
- b) in the case of self-preparers, there is evidence of different behaviour between those lodging paper as against e-filed returns.

With this knowledge Section 4 will examine what implications any observations made might have for deduction design and administration of the Australian personal income tax.

Table 3 Annual growth rates for personal taxable income and deduction: Australia 1998-99 to 2013-14

	2003-04 to 2012-13		1998-99 to 2013-14	
	Change in Claimants	Change in Average Claim	Change in Claimants	Change in Average Claim
Total Income or Loss	1.4%	5.3%	1.5%	4.5%
Taxable income or loss	1.2%	5.3%	1.6%	4.7%
Total work related car expenses	3.5%	2.9%	4.6%	3.4%
Work related travel expenses	7.2%	1.3%	6.8%	1.9%
Total work related uniform/clothing expenses	2.8%	1.7%	1.1%	3.5%
Total work related self-education expenses	0.9%	3.1%	1.1%	3.5%
Other work related expenses	2.5%	3.6%	1.6%	4.8%
Total work related expenses	2.0%	4.2%	1.9%	5.3%
Gifts or donations	1.7%	5.9%	2.0%	7.2%
Cost of managing tax affairs	2.3%	6.3%	1.7%	6.5%
Total Deductions	1.7%	3.0%	1.5%	3.3%
Rent interest deductions	3.3%	4.3%	4.3%	6.3%
Rent capital works deductions	7.8%	5.0%	9.9%	4.3%
Rent other rental deductions	8.9%	-5.0%	9.3%	-7.2%

Note: Colour code is red below values for Total Income or Loss – the benchmark – and green above with the strength of the colour change reflecting greater distance from the benchmark value

Source: Table 1 at <http://data.gov.au/dataset/25e81c18-2083-4abe-81b6-0f530053c63f/resource/3cd6dee1-785f-4876-a282-ebcf00f9949a/download/Taxstats2014Individual01SelectedItemsByYear.xlsx>

3 HAS E-FILING CHANGED AUSTRALIAN PERSONAL INCOME TAXPAYER DEDUCTION BEHAVIOUR?

Figure 1 (and Table 1) highlighted the rise in *e-tax* lodgements by self-preparers in Australia since 1998-99, the corresponding decline in paper-based lodgements, and the small decline in those lodging through tax agents. With pre-filing becoming established in 2006-07, there was a perceptible rise in self-preparers in that year, especially in *e-tax* preparers who rose 246,000 offset by paper lodgements falling 65,000. With returns lodged through tax agents rising 170,000 at a time when the overall increase in tax filers was 354,000, self-preparers were over 50% of net new filers, significantly up on its typical quarter share of all tax filers. In 2007-08 this trend continued with e-filers rising 370,000

¹⁶ This is the approach adopted by the ATO when it makes public and promotes deduction benchmark ratios for small business and selected professions. See <https://www.ato.gov.au/Business/Small-business-benchmarks/>

while total new filers rose 432,000 and those with tax agents rising 57,000. Of the increase in tax filers in 2007-08, only 13% on balance filed to tax agents while 87% filed through *e-tax*.

This rapid rise in *e-tax* returns in 2007-08 can be largely attributed to the Federal Government requiring taxpayers to have lodged their 2007-08 returns to be entitled from April 2009 to the \$900 cash bonus related to the global financial crisis economic stimulus package. However, in 2008-09 those who rushed to collect the bonus did not return resulting in a fall in tax filers of 86,000 (and taxable individuals of 501,000). With the number of *e-tax* and paper filers both increasing in 2008-09, the burden of this fall in overall tax-filers fell on tax agents who filed 228,000 less returns in 2008-09 than 2007-08.

Since 2008-09, the steady inroads *e-tax* made into the share of individuals lodging with tax agents has reversed, despite the availability of a Mac version of *e-tax* in 2012-13. Some insight into the cause of this trend is evident in Figure 2 which shows a decline in the real value of WRE claims since 2007-08. If this decline is the result of increased ATO compliance activity then because tax agents can provide taxpayers with the reassurance that they are less likely to be audited – especially if they have substantial deductions – then they have an incentive to lodge through a tax agent and be less ambitious with their claims. This might also explain why the return to tax agents has seen the average cost to taxpayers of having their tax affairs managed by an agent increasing 151% between 1998-99 and 2013-14 while average taxable income increased only 91% (and average weekly ordinary time earnings (AWOTE) by 95%). The net result is that the trend toward electronic lodgement by self-preparers has over the longer term, had little impact on tax agents, especially when there is more focus by revenue bodies on compliance, especially in relation to claimed deductions.

The question now is whether this changing mix in the method of tax return lodgement has in any way impacted on how Australian taxpayers have gone about claiming their income related deductions.

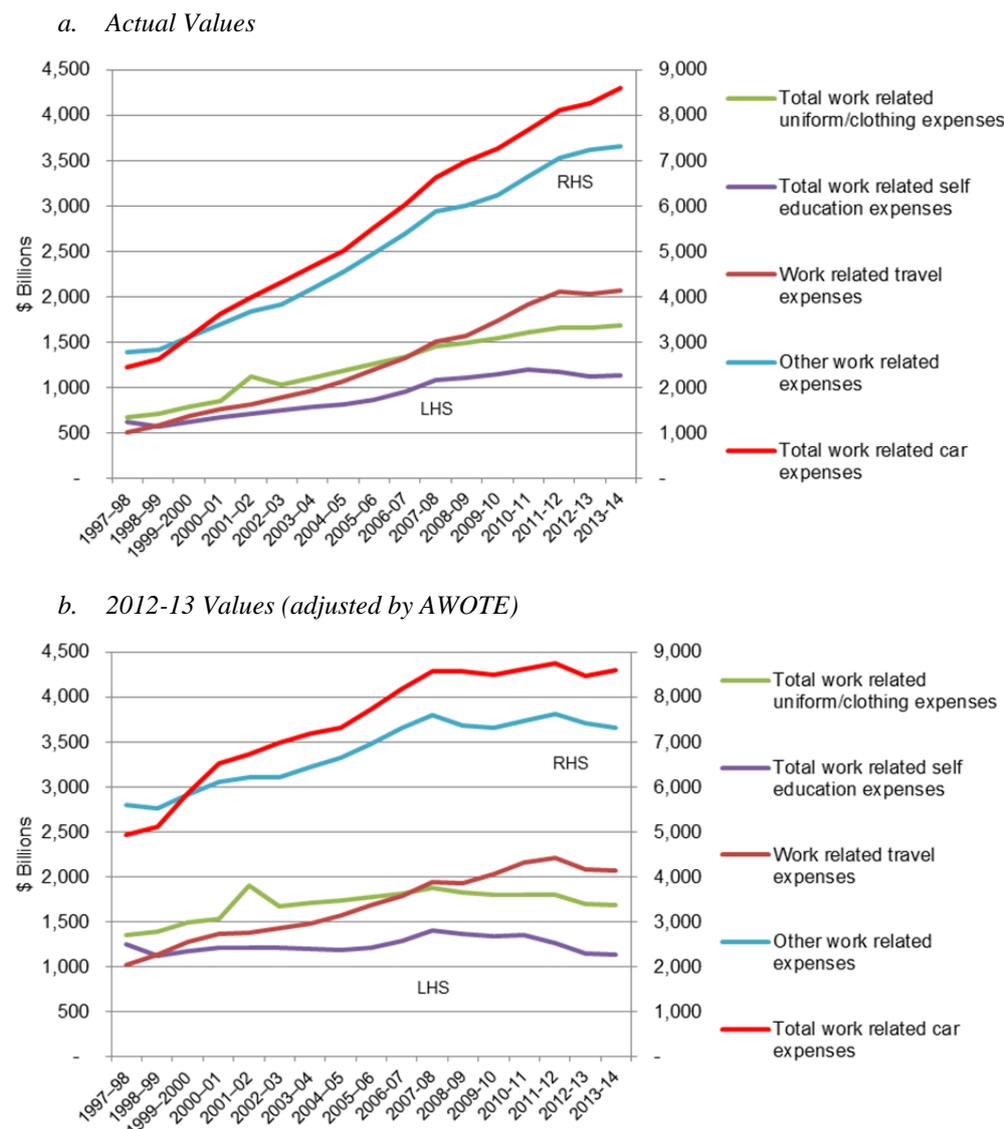
3.1 Evidence by method of lodgment

The focus of this section will be on those deductions where the individual has discretion about what and how much of a deduction to claim. For this reason, the cost of managing an individual's tax affairs is not relevant as self-preparers will not typically have such a claim (although some do in practice). Less important too are deductions which carry over from a previous period or those which are relatively small in value such as donations and gifts to charities.¹⁷ Where the greatest discretion exists in the Australian system is with work-related expenses (WRE) and “other” expense claims related to residential rental properties. With work-related expenses being \$20.8bill in 2013-14 and “other” rental property deductions being \$18.4bill,¹⁸ individuals have some discretion at the margin over their deduction claims.

¹⁷ In 2013-14, work related expense deductions totalled \$20.8bill, donations to charities some \$2.6bill and the cost on managing tax affairs, \$2.3bill while taxable income was \$740.7bill. See Table 1 at <http://data.gov.au/dataset/25e81c18-2083-4abe-81b6-0f530053c63f/resource/3cd6dee1-785f-4876-a282-ebcf00f9949a/download/Taxstats2014Individual01SelectedItemsByYear.xlsx>

¹⁸ Rent interest deductions were \$21.4bill and capital works deductions \$2.7bill in 2013-14. Source as for footnote 17

Figure 2 Trend in Work Related Expenses:1997-98 to 2013-14¹⁹



Source:

Tax data was derived from Table 1 at <http://data.gov.au/dataset/25e81c18-2083-4abe-81b6-0f530053c63f/resource/3cd6dee1-785f-4876-a282-ebcf00f9949a/download/Taxstats2014Individual01SelectedItemsByYear.xlsx>
 AWOTE is derived from ABS publications 6301.0 “Table 1 Average Weekly Earnings, Australia (Dollars) – Trend” and data in the column headed “Earnings; Persons; Full Time; Adult; Ordinary time earnings” [<http://www.abs.gov.au/ausstats/meisubs.NSF/log?openagent&6302001.xls&6302.0&Time%20Series%20Spreadsheet&37EB872D1A0BBB32CA257E9F00141FDB&0&May%202015&13.08.2015&Latest>]

In relation to work-related expenses, undocumented minimum claims or deductions which have elements of private consumption could be encouraged by a combination of ease of lodgement and rapid refunds. In the case of rental income “other” deductions, these too could have some private consumption element or include some of the expense which might relate to the owner-occupied property rather than the rental property or is capital in nature.

Without commenting further on how trends might have evolved and related compliance issues, attention will now be focused on whether there is evidence over the period 2003-04 to 2012-13²⁰, of

¹⁹ The data for the latest two years is preliminary and should be used with care. See footnote 13

²⁰ The ATO 2% sample file was released on 18 March 2016, too late for inclusion in the analysis in this draft of the paper.

differential deduction claim patterns over time according to how individual income tax returns are lodged. While taxpayer sample data were available between 2003-04 and 2010-11 for lodgements which distinguished paper and *e-tax* self-preparers, for the period 2011-12 and 2012-13 data are only available for “all self-preparers” whether they e-filed or lodged paper returns. With paper returns becoming an increasingly small proportion of self-preparer returns (Table 1), this loss of detail while unfortunate is not fundamental as by far the greatest majority of self-preparers are e-filers (83% in 2012-13 from Table 1).

Table 4 Change in number of individuals and average value of deduction for individuals with >\$20,000pa (2012-13 values): 2003-04 to 2012-13 (Code 0)

a. Change in number for individuals

Code	Number of Individuals	Work Related Expenses	Rent interest deductions	Other rent deductions	WRE - Car	WRE - Travel	WRE - Uniforms	WRE - Self Education	WRE - Other	
How did number of claimant change over the period?										
2003-04 to 2012-13										
Via Tax Agent	0	14%	22%	32%	27%	33%	68%	32%	3%	27%
Self-Preparer	1	30%	41%	95%	69%	82%	232%	55%	45%	46%
ALL	3	18%	26%	36%	31%	42%	100%	37%	18%	31%
2003-04 to 2010-11										
Via Tax Agent	0	8%	14%	17%	14%	22%	52%	22%	6%	18%
Self-Preparer	1	34%	46%	82%	63%	76%	212%	60%	58%	49%
ALL	3	14%	21%	21%	18%	31%	83%	30%	24%	24%
Paper Return	1	-47%	-45%	-17%	-17%	-31%	-3%	-41%	-46%	-40%
e-Tax Return	2	157%	160%	203%	177%	176%	494%	185%	187%	153%

b. Change in average values of claimants

Code	Total Income	Work Related Expenses	Rent interest deductions	Other rent deductions	WRE - Car	WRE - Travel	WRE - Uniforms	WRE - Self Education	WRE - Other	
How did average value for claimant change over the period										
2003-04 to 2012-13										
Via Tax Agent	0	52%	39%	64%	60%	26%	23%	14%	31%	35%
Self-Preparer	1	53%	70%	54%	51%	49%	17%	26%	24%	54%
ALL	3	52%	43%	63%	59%	27%	13%	16%	26%	38%
2003-04 to 2010-11										
Via Tax Agent	0	36%	32%	71%	39%	25%	22%	11%	23%	25%
Self-Preparer	1	40%	59%	69%	31%	44%	18%	21%	29%	43%
ALL	3	36%	34%	71%	38%	26%	12%	13%	22%	27%
Paper Return	1	47%	91%	71%	45%	68%	115%	26%	39%	68%
e-Tax Return	2	33%	38%	71%	33%	35%	-9%	24%	11%	31%

Source: ATO Personal Income Tax 1% sample unit record file for 2003-04 to 2010-11 and the 2% Taxpayer Sample Files for 2011-12 to 2012-13. [<https://data.gov.au/dataset/taxation-statistics-individual-sample-files>]

Notes: Colour coding is based on individual rows with white determined by the value for the first column which is either number of individuals or average total income. Red indicates values below the midpoint and blue above.

Table 4 provides some insight into the trends in those deductions which are significant and where taxpayers have some discretion. The results presented only relate to those taxpayers with total income greater than \$20,000pa in 2012-13 values because there was a large change in the tax free threshold in 2012-13 which removed many taxpayers from having to lodge returns.²¹ To ensure the results are not impacted by this threshold change, those removed from having to lodge returns in 2012-13 were also removed from our 2003-04 data²².

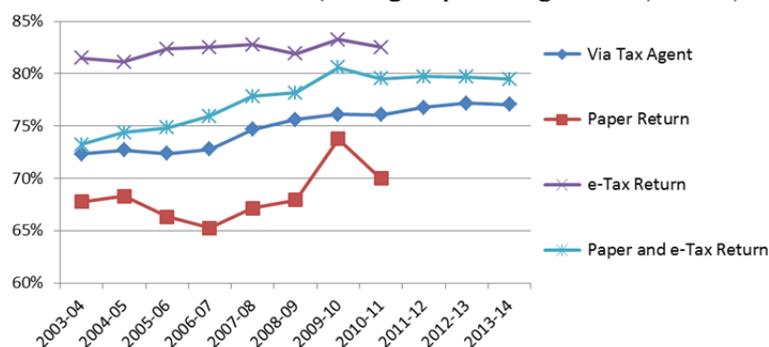
²¹ In 2011-12 the tax free threshold under the personal income tax was \$6,000 while for 2012-13 it was \$18,200. See <https://data.gov.au/dataset/taxation-statistics-2012-13/resource/75dd17be-0f73-456f-9a5a-3278cd160706>

²² Note that the sample selection filter is applied to the sample files such that individuals are selected only where annual total income is greater than \$20,000pa in 2012-13 values. Average Weekly Ordinary Time Earnings (AWOTE) forms the basis

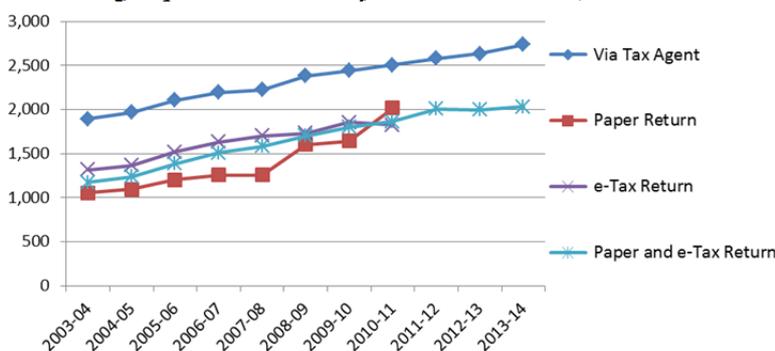
In relation to work related expenses, Table 4 shows that self-preparer’s average total income rose 53% while average deductions of claimants rose 70%. The origin of this 70% increase is not straightforward. From Table 4a we can see that underlying this 70% is a 41% increase in claimants who are now claiming less relative to their income than before. This implies that over time, more individuals are claiming more of these deductions even though they are on average claiming less of this type of deduction. What is important to the issue under investigation in this paper is therefore not just the amount but also the incidence of claims by the selected groups of filers.

Figure 3 Work Related Expenses: 2003-04 to 2013-14

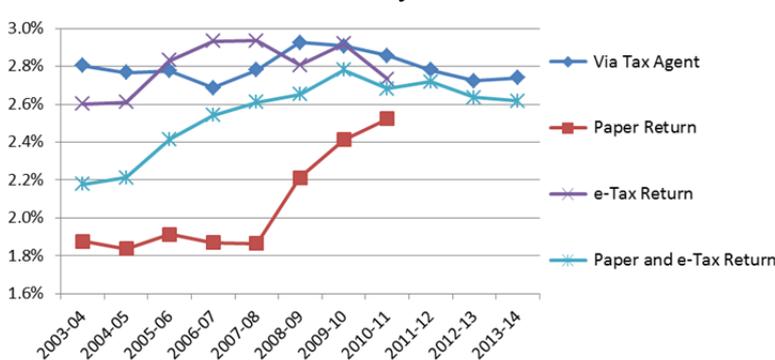
a. Incidence of claimants (% of group making a claim) (Code 21)



b. Average \$pa WRE claim by claimants (Code 0)



c. WRE as a % of total income by claimants (Code 16)



Source: As for Table 4

on which incomes are adjusted over the period 2003-04 and 2012-13. Data used on AWOTE is derived from ABS publications 6301.0 “Table 1 Average Weekly Earnings, Australia (Dollars) – Trend” and data in the column headed “Earnings; Persons; Full Time; Adult; Ordinary time earnings” [<http://www.abs.gov.au/ausstats/meisubs.NSF/log?openagent&6302001.xls&6302.0&Time%20Series%20Spreadsheet&37EB872D1A0BBB32CA257E9F00141FDB&0&May%202015&13.08.2015&Latest>]. The change in average values of income and deductions are then measured based on the current nominal values of these variables in the years selected.

Where the higher incidence of claims are most pronounced is with self-preparers as shown in Table 4a in the case of the different WREs, rising some 232% in the case of self-preparers claiming WRE-Travel over the period 2003-04 to 2012-13. However, amongst self-preparers, it would appear that there is another complicated pattern emerging.

Over the period for which we have separate data for self-preparers lodging with paper and *e-tax*, 2003-04 and 2010-11, there was a 212% increase in the incidence of claims for WRE-Travel. Since the incidence of claims for *e-tax* claimants rose 494% when the number of such individuals increased 157%, compared to paper return claimants falling 3% when the number of these taxpayers fell 47%, the incidence of claims with *e-tax* lodges is higher. Put differently, for *e-tax* individuals this can be thought of as the number lodging returns effectively rising from 100 to 257 and the number claiming WRE-Travel rising from 100 to 594, while for those lodging paper returns, the number lodging returns effectively fell from 100 to 53 and the number claiming WRE-Travel fell from 100 to 97.

Explaining the findings in Table 4 is therefore complicated by changes in the number of taxpayers in aggregate, the share in each category and the average level of each claim. In the case of total WRE, Figure 3 reveals that the results in Table 4 for *e-tax* filers is not driven by the incidence of claims over the period (Figure 3a) but by average claims increasing faster in percentage terms (coming off a lower base shown in Figure 3b) when compared to those filing through tax agents who claim more on average but have a lower claim incidence. In fact, the rate of claim for total WRE amongst self-preparer has diverged (now being much higher) than for those filing with tax agents.

Table 5 Index of relative behaviour between 2003-04 and 2012-13 (Code 0)

a. Index of claimants (normalised for change in number of individuals): 2012-13 = 100 for All Individuals

Method of lodgement	WRE- Car	WRE - Travel	WRE - Uniforms	WRE - Education	WRE - Self	WRE - Other	WRE-All	Rent interest deduction	Other rent deductions
Index in 2012-13									
Via Tax Agent	117	147	115	91	111	107		116	112
Self-Preparer	140	256	120	112	112	109		150	130
<i>Difference</i>	24	109	4	21	1	2		34	19
Index in 2010-11									
Via Tax Agent	112	140	112	98	108	105		108	105
Self-Preparer	131	232	119	118	111	109		135	121
<i>Difference</i>	19	92	7	19	3	3		27	16
Paper Return	130	182	111	101	112	103		157	157
e-Tax Return	108	231	111	112	99	101		118	108
<i>Difference</i>	-22	49	1	11	-13	-2		-39	-49

b. Index of average value of claims (normalised for change in average income): Index-100 for All Individuals

Method of lodgement	WRE- Car	WRE - Travel	WRE - Uniforms	WRE - Education	WRE - Self	WRE - Other	Work Related Expense	Rent interest deduction	Other rent deductions
Index in 2012-13									
Via Tax Agent	82	81	75	86	89	91		107	105
Self-Preparer	97	77	82	81	101	111		100	98
<i>Difference</i>	15	-4	8	-5	12	20		-7	-7
Index in 2010-11									
Via Tax Agent	92	90	82	90	92	97		126	102
Self-Preparer	102	84	86	92	102	113		121	94
<i>Difference</i>	11	-5	5	2	10	17		-5	-8
Paper Return	114	147	86	94	115	130		117	99
e-Tax Return	101	69	93	83	99	104		129	100
<i>Difference</i>	-13	-78	8	-11	-16	-26		12	1

Source: Source: As for Table 4

Notes:

The data in Tables 4 and 5 are related. For example in the case WRE-Travel in Table 4 for Paper Returns, the value of 182 in Table 4a can be derived using the corresponding cell data in Table 4a as follows: $182 = [(1 + .03) = 97] / [(1 + .47) = 53]$ Colour coding is determined on the basis of the grouping of two row with white being determined by the 50 percentile midpoint and blue below this midpoint and red above.

While Figure 3 is revealing for total WRE, the challenge for this paper was how to simply disaggregate the data in Table 4 for different types of deductions to reveal the source of change in each case over time. The solution was to develop indexes capable of distinguishing the average level of claims from the incidence of claims within and across groups of individuals.

Table 5 reports on indexes which partition the findings in Table 4 into measures which reflect the growth in the number of taxpayers claiming different deductions and the growth in the average claim in each case. For example, a value of 117 in the first row of Table 5a is the ratio of $(1+33\%/1+14\%)$ from the corresponding row in Table 4. The value of 117 can be interpreted as meaning that WRE-Car for 2012-13 for “Via Tax Agent” was a 17% increase on the number of claimants relative to the number of taxpayers over the period since 2003-04. A value less than 100 (blue) implies a fall in the relative number making a claim. In the case of Table 5b (which draws on Table 4b), blue indicates that the average claim fell relative to average income and red, that it increased.

Table 5 therefore allows us to visually (and numerically) understand changes in the incidence amongst taxpayers of their rates of claim (Table 5a) and changes in the average claim relative to the average income (Table 5b) of each group identified in the rows.

What Table 5 reveals is that in almost all cases, there has been a growth in the rate of claim amongst taxpayers (red in 5b) and a trend towards falls in the average level of claim. The two are obviously not unrelated and can be explained by the new claimants having relatively modest claims.

Since this paper is primarily interested in the behaviour of self-preparers as against paper and *e-tax* lodgements, the differential trends for self-preparers who lodge with paper or *e-tax* is of particular interest. While data are only available for those lodging through paper or *e-tax* for the period 2003-04 to 2010-11, what Table 5 reveals is that there are quite different outcomes for those lodging through tax agents (coloured row 1 in each of 5a and 5b) and those through paper (coloured row 5) and *e-tax* (coloured row 6). Reading off the colour coding in Table 5, the incidence of claims for self-preparers rose above those using a tax agent and those up until 2010-11 lodging with paper, had a greater claim incidence for WRE-Car and WRE-Other. Paper return lodgers also tended to have a far greater claim rate in relation to rent-interest and rent-other deductions. What is not immediately clear is whether the results for paper self-preparers is just a consequence of those who have not as yet gone electronic or is in some way revealing a trend amongst these individuals.

What Table 5a does reveal in coloured row 1 and 2 is that there is clearly a trend towards a higher incidence of claims amongst self-preparers. However, it is important to complement this finding on incidence with that in Table 5b on the level of the claim relative to income. It would appear that for paper return lodgers (coloured row 5), that in most cases in relation to WRE, their level of claim is relatively higher than for *e-tax* (coloured row 6) – although in some cases the level relative to income did fall for paper preparers (blue in coloured row 5 of Table 5b).

The results in Tables 5a and 5b when combined highlight a marked divergence between the results of self-preparers and those with tax agents – for the former there is a greater incidence of claims (coloured row 2 vs 1 in 5a) and a greater relative claim (coloured row 2 vs 1 in 5b). With paper self-preparers as against *e-tax* lodgers, while there is a mixed picture for incidence (coloured row 6 vs 5 in 5a), the average claim relative to income appears to be higher for paper as against *e-tax* (coloured row 6 vs 5 in 5b).

Can it be concluded that a move to *e-tax* increased the relative incidence of claims and the amount claimed for this group as against other groups? What is apparent is a higher incidence of WRE claims

amongst self-preparers (coloured row 2 vs 1 in 5a) who by 2012-13 were largely *e-tax* lodgers with the level of claim relative to income (coloured row 2 vs 1 in 5b) rising more for self-preparers than for those lodging through tax agents. There is clearly something very different happening with self-preparers which warrants further investigation.

Table 6 attempts to cast some light on what the changes in incidence of claims and the level of claims means for the aggregate level of claims relative to aggregate total income – in effect, the outcome of the combination of factors at work in Table 5. The indexes in Table 6 are benchmarked against the change in the aggregate level of income over the periods shown. A value greater than 100 (in red) indicates the aggregate value for the variable grew faster than aggregate total income and below 100, slower (in blue). The rate of growth for the deductions shown was consistently greater for self-preparers over those lodging through tax agents – and quite markedly so (coloured rows 1 and 2 in Table 6). While the experience for paper lodgers appears quite different from *e-tax* lodgers, this as noted above could simply be the product of the characteristics of taxpayers who are reluctant to lodge any other way than paper, rather than by any specific action (or reaction) by these individuals. What is more important is the differing pattern of results for self-preparers over those with tax agents.

However the results and findings from Tables 5 and 6 needs to be tempered with the data reported in Table 8a on the average level of claim across the different groups. Those persons with tax agents at the highest level of average WRE claim and those with paper returns typically lowest. This trend is however, not borne out in the case of rental deductions where those lodging paper returns are not too different from those with tax agents, with those lodging through *e-tax* having the lowest average claims. In relation to WRE, what self-preparers (paper or *e-tax*) might be doing is simply “catching up” to the activities of lodgers through tax agents. However, what Tables 5 and 6 above do indicate is that the level of claim relative to income of those using tax agents has moderated in recent years – but less so for self-preparers. Whether this is the consequence of increased ATO compliance activity – simply the setting a benchmark deduction ratios for different professions – and possible conservatism by tax agents, is unclear.

Table 6 Index of aggregate value of claims: 2003-04=100 (Code 11/16)

Method of lodgement	WRE- Car	WRE - Travel	WRE - Uniforms	WRE - Self Education	WRE - Other	Work Related Expenses	Rent interest deduction	Other rent deductions
Index in 2012-13								
Via Tax Agent	96	118	86	78	99	97	124	117
Self-Preparer	136	196	98	91	113	121	151	128
Difference	40	78	12	13	14	24	26	11
Index in 2010-11								
Via Tax Agent	103	126	92	88	99	102	136	107
Self-Preparer	134	196	103	108	113	123	163	114
Difference	31	70	11	20	14	21	28	6
Paper Return	149	267	95	95	128	135	183	155
e-Tax Return	109	159	104	93	97	105	152	108
Difference	-40	-108	9	-2	-31	-29	-31	-48

Source: Source: As for Table 4

Notes: Colour coding is determined on the basis of the grouping of two row with white being determined by the 50 percentile midpoint and blue below this midpoint and red above.

3.2 Other explanatory variables

While the above analysis has sought to investigate differences in the incidence and level of claims amongst taxpayers using different methods of filing tax returns, the interesting question which this raises is whether any trends observed are the result of changes in taxpayer behaviour or the result of

changes in the composition of those taxpayers. It is quite possible that what is being seen with *e-tax* lodgers is movement across the different categories of filers rather than just movement within tax agent and self-preparers.

Table 7 Personal income deduction trends in Australia: 2003-04 to 2012-13

		<i>Gender</i>	<i>Age</i>	<i>Occupation</i>	<i>Partner Status</i>	<i>Total Income</i>
2012-13	Tax Agent (Filtered)	0.443	0.507	0.388	0.585	1.284
	Self Preparer (Filtered)	0.480	0.603	0.451	0.528	1.040
	All	0.478	0.532	0.388	0.553	1.000
2003-04	Tax Agent (Filtered)	0.436	0.549	0.386	0.578	1.298
	Self Preparer (Filtered)	0.472	0.630	0.366	0.487	1.046
	All	0.479	0.584	0.369	0.536	1.000
% Change	Tax Agent (Filtered)	1.5%	-7.6%	0.6%	1.3%	-1.0%
	Self Preparer (Filtered)	1.7%	-4.3%	23.1%	8.3%	-0.7%
	All	-0.3%	-8.9%	5.2%	3.2%	0.0%
Index		0=Male 1=Female	0=>70yo 1=20yo	0=Professional 1=Labourer	0=single 1=Partner	1=Average

Source: Source: As for Table 4

Table 7 attempts to provide some insight into the income and demographics of individuals lodging tax returns divided between self-preparers and tax agent filers. The only apparent marked variation between groups over the period was in the index for occupation with self-preparers trending towards the labourer and away from the professional end of the occupation spectrum, findings similar to Azleen, Zulkeflee, Rushdan(2009). Groups categorized by aged and gender was not an issue and self-preparers were less likely in 2012-13 to be single than they were in 2003-04. Income levels were quite different across the groups but the differences remained stable across the period and therefore cannot explain differences across time between groups.

4 STRATEGIES FOR RESOLUTION OF ANY ELECTRONIC LODGEMENT RELATED COMPLIANCE RISK

The above analysis has indicated that since the introduction of electronic lodgement in Australia, there is evidence of changed income deduction claims behaviour by self-preparers when compared to those lodging via tax agents. While drawing a direct link between the increased incidence of claims and the take-up of electronic lodgement may be controversial, what is not in dispute is that this trend occurred and merits closer review to better understand if it was in any way related to electronic lodgement. However, regardless of its cause, the trend in a policy stable environment must be studied further.

If in some way a part was able to be attributed to the take-up of electronic lodgement with its significantly shorter guaranteed refund period, then greater attention must be given to complementing pre-filing of income with more rigorous compliance checks of claims. While apps like the ATO *myDeductions* app may ultimately help with pre-filing deductions, such an app imposes ongoing compliance costs to taxpayers and is unlikely to find widespread take-up.

If government is concerned by the increased incidence and high compliance and administrative costs associated with deduction claims, then there is potential merit in investigating alternative strategies for giving tax relief for deductions. Table 8 summarises the incidence and level of claims if such claims were capped, providing an indication of the number of filers and the amount claimed below these caps. In 2012-13, 66.6% of taxpayers claimed WRE but if the threshold above which claims could be made was set at \$300 then 15% of filers or 23% of those with WRE would not be able to claim and if set at \$1,000, the corresponding figures would be 35% and 53% respectively. In the case of gifts and donations, 36% of taxpayers claimed this deduction but if the threshold above which

claims could be made was set at \$25 then 7% (and 19% of those with gifts and donations) would not claim and if set at \$50, then 12% (and 32% of those with gifts and donations). Even when all deductions are combined (excluding those for rental properties), deduction claims for many are quite modest with just 6.8% of all deduction in value coming from 48.6% of deduction claimants (or 39.6% of all filers).

Table 8 Deductions claimed below selected thresholds: Australia 2012-13

		Claimants			Deduction	
		(m)	% All	% All filers	(\$m)	% value
Gifts and deductions						
Threshold	\$25	0.836	18.5%	6.6%	\$12	0.6%
for claim	\$50	1.463	32.4%	11.5%	\$36	1.8%
	\$100	2.237	49.5%	17.6%	\$91	4.4%
	Unlimited	4.522	100.0%	35.6%	\$2,055	100.0%
Work-related expenses						
Threshold	\$300	1.909	22.6%	15.0%	\$367	1.9%
for claim	\$500	3.089	36.5%	24.3%	\$803	4.1%
	\$1,000	4.488	53.0%	35.3%	\$1,818	9.2%
	Unlimited	8.465	100.0%	66.6%	\$19,659	100.0%
All deductions						
Threshold	\$500	3.313	32.0%	26.0%	\$850	2.7%
for claim	\$1,000	5.028	48.6%	39.5%	\$2,094	6.8%
	\$2,000	6.680	64.5%	52.5%	\$4,458	14.4%
	\$5,000	8.746	84.5%	68.8%	\$11,308	36.5%
	Unlimited	10.356	100.0%	81.4%	\$30,952	100.0%

Source: Source: As for Table 4

What Table 8 demonstrates is that the access by filers to deductions in Australia has led to broad take-up of this option with relatively modest benefit – especially given the compliance and administrative cost – for most taxpayers. If the availability of deductions is a constraint on both pre-filing and taxpayers having the option to all the revenue body to assess their tax liability without lodging a return, then as noted earlier, either the availability of deductions must be limited or procedures put in place to enable their pre-filing. Several options are available to policy makers including:²³

1. guaranteeing all taxpayers some “standardised” level of deduction above which any claims above this level needing to be documented and electronically submitted with the tax return,²⁴
2. As for (1) but where the “standardised” deduction is complemented with a cap related to a percentage of income,²⁵
3. only allowing deductions above some threshold (as with the current Australian medical expense tax offset²⁶);
4. reducing the rate at which income deductions generate tax relief and therefore reducing the incentive to claim deductions by imposing a low flat rate of tax rebate rather than the

²³ For a discussion of the options and issues see Warren(2014a, 2014b).

²⁴ In the AFTS(2009, Vol 1 p57(Henry Review)), it was proposed in Recommendation 11 that “A standard deduction should be introduced to cover work-related expenses and the cost of managing tax affairs to simplify personal tax for most taxpayers. Taxpayers should be able to choose either to take a standard deduction or to claim actual expenses where they are above the claims threshold, with full substantiation.”

²⁵ See discussion in Warren (2014b) for a discussion of this option in the Australian context.

²⁶ This tax offset is currently being phased out, see <https://www.ato.gov.au/Individuals/Income-and-deductions/Offsets-and-rebates/Medical-expenses/>

taxpayer's marginal tax rate when calculating the income tax offset generated through deductions;

5. mandating that all deduction claims must be filed through deductions software such as the ATO *myDeductions* app, effectively enabling tax administrators to not only monitor deduction claims but to pre-fill deduction claims on tax returns;
6. some combination of 1 to 5 above

While the above options are by no means exclusive of all possibilities, they would act to reduce the incentive electronic lodgement might have for excessive or undocumented claims which pose a revenue risk to government. They would also act to reduce enforcement costs for tax administrators although this would be at the expense of increased compliance costs for taxpayers. However, simple measure such as (1) (and 2), while attractive for their simplicity in reducing the number of filers needing to formally claim deductions, could have a significant revenue cost if the level is set high and is available to a broad range of taxpayers.²⁷

An additional concern is that any policy actions designed to address compliance risk and complexity might impinge on economic efficiency and equity by denying (or at least curtailing) legitimate deductions as with (3). While ever some deductions remain available and there is income prefilling, information asymmetry between the taxpayer and the tax administrator must be addressed, especially in an environment where tax refunds related to those deductions are expedited compared to those lodging paper returns. While policy change is an option, only through denial of any deductions does it remove compliance risk with deductions and until such a policy position is adopted, electronic lodgement must be complemented with equal focus on prefilling deductions *and* income to minimize compliance risk.

²⁷ If the "standardised" deduction was available to only those in full-time employment then this might not be an issue but if it was also available to part-time (however defined) and the self-employed, then its cost could be a major constraint on pursuing this policy option.

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