FSC FINANCIAL SERVICES COUNCIL

11 March 2014

General Manager
Tax System Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear General Manager

RE : DISCUSSION PAPER - ENHANCED THIRD PARTY REPORTING, PRE-FILLING AND DATA MATCHING

Thank you for the opportunity to provide comment on the Treasury discussion paper "Improving tax compliance — enhanced third party reporting, pre-filling and data matching".

The Financial Services Council represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, trustee companies and public trustees. The Council has over 125 members who are responsible for investing more than $2.2 trillion on behalf of 11 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the third largest pool of managed funds in the world. The Financial Services Council promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

The FSC has significant concerns in relation to enhanced third party reporting as outlined in the discussion paper. Our comments are limited to the application of the regime to sales of shares and units.

In particular we are concerned that this initiative:

- is inconsistent with the government's deregulation agenda as it will impose a significant administrative burden on industry;
- will result in inaccurate reporting and unusable data, due to the reporting entity not being in an appropriate position to report on the taxation position of an individual investor;
- will be costly to implement, as much of the data required is not captured currently, and that which is collected is only currently reporting annually; and
- cannot be implemented by 1 July 2014 due to the system build time required.

We have provided further detail on our concerns in Appendix A.

Whilst we understand the government's intention we feel the approach will not yield the

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desired result and will result in significant inaccuracies for individual investors at tax time, in addition to unnecessary cost impositions on the industry.

A better approach would be for reporting entities to notify the ATO of CGT event triggers on an annual basis through the existing AIIR process. This would allow the ATO to make the necessary enquiries of an investor who does not report a CGT event in their annual tax return. It would remove the impossible and impractical obligation the proposal places on the reporting entity to determine the CGT basis on which the investor intends to treat the disposal when they make their annual taxation return. A solution such as this could be implemented provided a reasonable timeframe for system development was allowed.

Should you wish to discuss this submission further please do not hesitate to contact me on (02) 9299 3022.

Yours sincerely

CARLA HOORWEG
Senior Policy Manager – Investment, Global Markets & Tax

Appendix A

Section 2.2 - sales of shares and units

General Comments

Currently Responsible Entities ("REs"), IDPS operators and Brokers do not provide information to the ATO in respect of the sale or redemption of units. REs, IDPS operators and some brokers may provide an AIIR to the ATO, however, this contains details of income rather than investments.

The AIIR contains details of an investor's name and address, TFN, date of birth, tax residency and typically entity type. It does not contain details of the investment holding. Its current purpose is to enable data matching of income to that disclosed in the tax return by the relevant investor.

Conceivably a reporting entity could include within its next AIIR details for individual investors of shares /units sold /redeemed. However the information that could be supplied would consist of:

- The company code and possibly HIN and SRN,
- Number of shares sold,
- Price received,
- Date of sale.

This information is not adequate to form the basis of a completed capital gains prefill for taxpayers. All that it is capable of doing is alerting the ATO to the fact that a share sale, or unit trust redemption, has taken place. In short the industry can provide a signal to the ATO that a CGT event has occurred but cannot provide a quantification of the capital gain that may arise from that event.

The reasons for this are as follows:

(Note the following discusses share sales and unit trust redemptions jointly. There are some aspects that will impact one but not the other, e.g. cost base reductions for tax deferred distributions, however for convenience the two situations have been discussed together.)

1. If a sale or redemption is for 100% of a holding it may be possible to estimate the original cost. However, if the disposal is for a proportion then it is necessary to determine which assets are actually being disposed of. Where the holding has been acquired over time there will be many different cost bases that underlie the bundle of assets.

   There are no rules mandating the identification of assets disposed of in cases of homogenous assets. Hence it is problematic for the reporting entity to assume on the investor's behalf which cost base the investor should apply. An investor could choose a FIFO ("first in first out") basis, LIFO ("last in first out") basis, weighted average cost, a

basis designed to minimise gains, a basis to ensure only assets held for more than 12 months are sold, or even a basis designed to maximise gains due to the presence of capital losses. The choice of which method to apply is made by the investing taxpayer not by the responsible entity, IDPS provider or broker.

This issue has two aspects. Firstly, identifying the cost base of the assets under review and, secondly, if assets were disposed of in an earlier period what cost base was assigned to them? Without knowing which cost bases an investor utilised in the past it is impossible to know which cost bases are available for the current disposal.

2. Unit trusts often make tax deferred distributions to investors. Such distributions have traditionally resulted in a reduction of the cost base which in time should, in turn, result in a larger capital gain on disposal. This issue is not just limited to unlisted unit trusts as there are many listed vehicles which consist of a "stapled" share and unit. A broker or IDPS operator will not necessarily be aware of all tax deferred distributions that have been received and thus cannot ensure that it has fully captured all cost base reductions required. This is further complicated when the issue referred to in point 1 above is considered because not all assets in the bundle held will have participated in all tax deferred distributions received.

   A further complication in this regard is that the ATO is currently challenging the status of tax deferred distributions. The industry has (and continues to) vigorously argued that this challenge is incorrect but nevertheless an element of uncertainty exists.

3. Many investments are the subject of what is often referred to as "corporate actions". This covers myriad variations but includes scrip for scrip takeovers, stock splits, share buybacks and spin offs. In many situations it is possible to elect for CGT rollover relief. Ultimately, the decision to so elect is up to the investor. A broker or IDPS provider will not necessarily know whether an election was made. In some instances, such as a capital loss, an election may not be available; however the broker or IDPS operator may not be aware of this.

4. If an investor acquired assets through another broker then incidental acquisition costs will not be known and thus cannot be incorporated into a capital gains calculation.

5. Some investors will have assets that still attract a CGT exemption (those acquired prior to September 1985) or which produce a better result under the indexation method than the discount method. Such exemptions and choices will not necessarily be known to the brokers, custodians and IDPS providers.

In summary, it is not possible for industry to provide details of capital gains arising from share and unit sales.

If an appropriate implementation time were granted it would be possible to provide details of disposals to the ATO that could be used as either a "prompt" on the prefill pack, or as an alert to the ATO to facilitate ensuring a capital gain has at least been reported.

Response to Consultation Questions

How could these obligations be modified to minimise your compliance costs?

a) Annual reporting is preferred, to minimise compliance costs. Annual reporting will:

- Have improved accuracy of data (some information would not be available quarterly or using real time transactions);
- Have lower administration costs of performing annual reporting;
- Be aligned to the current income reporting frequency, i.e. the AIIR

b) Limit the historical information required. While we may hold the information in our systems, we must consider the following:

- Our ability to retrieve historical data from systems is low and requires system changes.
- We may be unaware of the taxpayer's parcel selection methodology thus won't be able to provide parcel cost on sales.

c) Limit the requirement of incidental costs, such as broker's or accountant's fees, as we do not have all the external party costs related to the purchase/ sale of shares and units.

Would it be feasible to collect all the information sought by the ATO?

No, as we are not aware of all the costs incurred by the taxpayer in relation to holding shares and units, such as accounting and financial planner's fees.

What would constitute the bulk of your compliance costs (implementation or ongoing) in complying with these obligations? Would a more frequent reporting obligation (such as quarterly or monthly) impose significantly more ongoing compliance costs than an annual obligation?

Implementation of changes to comply with these obligations would attract a significant cost as it was not foreseen that we would be required to report on specific transactions through bulk reporting. Ongoing costs would continue to be significant as the information requested may be collected through multiple systems, requiring the reporting entity to develop new business processes.

More frequent reporting obligations would impose significantly higher compliance costs. Due to the complexity of the information required, new reports and scripts will have to be created to extract and collate the data. To provide high quality data to the ATO, it would take considerable time to match and reconcile information from multiple systems. Timing issues where transactions are corrected also have to be considered. If these reports are to be on a more frequent basis, then there may be an increase in amendments needed for error correction.

Is a start date of 1 July 2014 feasible? If not, how long would you need to develop any necessary system changes?

No, a start date of 1 July 2014 will not be feasible to have the technology changes in the required timeframes. Consideration also needs to be given to other reforms in the unit trust space that Treasury is currently progressing, for example the Managed Investment Trust Taxation regime - it would not be logical to start an enhanced reporting regime prior to these changes having been implemented.

Are there any other impediments to the ATO receiving or using this information?

There will be additional information that the taxpayer has to provide that we may not have access to, e.g. broker's or accountant's fees. Should this be required, it will increase the timing issues and cost of providing information to the ATO and is likely to decrease the quality of data provided.