



Submission to the House of Representatives
Standing Committee on Tax and Revenue
Inquiry into the External Scrutiny of the
Australian Taxation Office

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Introduction

The parliament should unequivocally reject any reduction in the level of scrutiny applied to the Australian Taxation Office (ATO).

The ATO lists five separate bodies which it considers as external scrutineers: the Australian National Audit Office, the Commonwealth Ombudsman, the Inspector-General of Taxation, Office of the Australian Information Commissioner, and the Productivity Commission.¹

However, with the transfer of responsibility for individual complaints about taxation from the Commonwealth Ombudsman to the Inspector-General of Taxation, four of these five oversight agencies have oversight of the ATO only insofar as the ATO is a statutory agency, rather than unique oversight of the ATO.

This system of a single dedicated inspector of the Commonwealth revenue collecting agency is the bare minimum one would require for a liberal democratic tax system. There is a strong case for increased monitoring and scrutiny of the ATO. We believe that this inquiry has been established under a dangerous assumption that the most important independent statutory authority in the Australian government should be freed from the current level of external monitoring. However, the inquiry presents parliament with an opportunity to tighten that monitoring. From both a liberal perspective and a democratic perspective, the ATO needs more scrutiny.

Independence and monitoring

We have written about the political economy of independent statutory agencies at length.² Independent agencies are severed from the normal Westminster lines of accountability. Where authority is delegated downwards from citizen, through parliament, through executive government and to the agency, the chain of accountability does not stretch upwards. Independence prevents political interference in economic governance but it brings about its own costs.

One of these costs is a loss of democratic control. With the dramatic increase in independent agencies in recent decades, this cost has led to a crisis of legitimacy, as public agencies shorn of democratic control take a larger role in economic and social governance.³ One further cost is increased discretion born by the acquisition of independence from normal lines of democratic accountability. Defenders of independence argue that independence prevents elected policymakers from imposing varied compliance burdens on regulated entities based on political rather than legal or technical grounds. In other words, politicians might ask the tax office to go easy on politically favoured firms or industries.

¹ <https://www.ato.gov.au/About-ATO/Access,-accountability-and-reporting/Our-scrutineers/>

² Sinclair Davidson, "Reserve Bank Independence and Inflation: Submission to the Senate Committee on Economics, Inquiry into the Reserve Bank Amendment (Enhanced Independence) Bill 2008," (Institute of Public Affairs, 2008); Chris Berg, *Liberty, Equality & Democracy* (Ballan, Vic.: Connor Court Publishing, 2015); *The Growth of Australia's Regulatory State: Ideology, Accountability and the Mega-Regulators* (Melbourne, Australia: Institute of Public Affairs, 2008).

³ Martino Maggetti, "Legitimacy and Accountability of Independent Regulatory Agencies: A Critical Review," *Living Reviews in Democracy* 2 (2010); Giandomenico Majone, "The Regulatory State and Its Legitimacy Problems," *West European Politics* 22, no. 1 (1999).

However, the elimination of political discretion does not eliminate discretion – rather, it devolves it down to unelected bureaucrats who have reduced levels of accountability to the electorate.

It has long been understood that bureaucracy have their own preferences which might not fully align with the preferences of the political agents who delegate towards them.⁴ For instance, a bureaucracy might favour the continuance of a program that maximises its discretionary budget and prestige while fully informed policymakers might prefer the abolition of that program. While statutory authorities operate within a legislative framework, they have considerable discretion to autonomously choose enforcement and compliance strategies within that framework. The process by which an agency's practices diverge from a legislature's intention is known as bureaucratic drift.⁵ This makes the ATO in a very real sense a policymaking authority external to the democratic process, and demands further scrutiny of its activity.

Compounding these problems are the regulatory and coercive powers granted to independent agencies. Legal rights – the presumption of innocence and burden of proof, the right to natural justice, the right to silence, and the privilege against self-incrimination – are most commonly violated at the Commonwealth level in legislation covering taxation and finance. As the IPA has found taxation "is an area of law with a significant legal rights deficit. The vast majority of tax assessment decisions are not reviewable and assessors often have coercive powers which remove the right to silence".⁶ Particularly pernicious in taxation acts are provisions which reverse the presumption of innocence and burden of proof. In this light, the ATO also has a quasi-judicial function with its ability to impose administrative penalties for compliance breaches. Around forty-five per cent of penalties in major tax legislation are administrative.⁷

Further influence over policy comes from the normal process by which legislative change is made in Australia.⁸ The ATO is as much a participant in the public debate around taxation as it is the administrator of the results of that debate. The ATO participates in government inquiries, provides public commentary on the state of taxation law in Australia, and lobbies politicians for changes. We have seen these activities in action during the debate over multinational tax avoidance, where the Tax Commissioner has given speeches, participated in personal profiles and launched publicity campaigns to argue that "action is needed" on corporate tax reform.⁹ Indeed, the fact that this inquiry is being conducted in the first place – reportedly at the behest of the Tax Commissioner's request – is strong reason to believe that the ATO is an autonomous publicly-funded political actor sufficient to be justly subject to extra monitoring and scrutiny.

⁴ William A. Niskanen, *Bureaucracy and Representative Government* (Chicago,: Aldine, 1971); "Bureaucracy: A Final Retrospective," in *Reflections of a Political Economist : Selected Articles on Government Policies and Political Processes*, ed. William A. Niskanen (Washington, D.C.: Cato Institute, 2008).

⁵ Kenneth A. Shepsle, "Bureaucratic Drift, Coalition Drift, and Time Consistency: A Comment on Macey," *Journal of Law, Economics and Organization* 8, no. 1 (1992).

⁶ Simon Breheny and Morgan Begg, "The State of Fundamental Legal Rights in Australia: An Audit of Federal Law," (Institute of Public Affairs, 2014).

⁷ Australian Law Reform Commission, "Principled Regulation: Federal Civil and Administrative Penalties in Australia," (Sydney: Australian Law Reform Commission, 2003).

⁸ This dynamic is explored in Chris Berg, "The Biggest Vested Interest of All: How Government Lobbies to Restrict Individual Rights and Freedom," in *Occasional Paper* (2013).

⁹ Greg Earl, "Digital Tax Faces Limits," *The Australian Financial Review*, 17 September 2014.

Current ATO Governance is inadequate

In 2011 the Inspector-General of Taxation made a submission to the Tax Forum.¹⁰ Importantly, that submission made this claim:

While the current ATO governance arrangements are considerable, there are a number of shortcomings that warrant examination in developing a more effective structure. The shortcomings include, a reliance on consultative forums as a substitute for a more participatory form of tax administration, practical limitations of the parliamentary committee process and the piecemeal development of the current governance arrangements, in particular the executive agencies overseeing the ATO and its administration.

Of particular concern was the view expressed by the Inspector General of Taxation that Parliamentary oversight of the ATO would likely be weak:

The parliamentary committee process has significant practical limitations in scrutinising the ATO (due to the ATO's size, scope and complexity in function). ...

The IGT has also found that taxpayers are reluctant or unwilling to raise their concerns in the administration of the tax system directly with the ATO or in parliamentary committees. A number of stakeholders have expressed concern about a fear of ATO retribution against those who publicly criticise the ATO's conduct or approaches.

In short, while the ATO might be subject to formal governance, that indeed may well be somewhat onerous, there is little substance to that governance. The importance of a well-governed ATO is further explained by the Inspector General of Taxation in his 2015 report into tax disputes:¹¹

The importance of a robust governance framework cannot be overstated. The ATO, by necessity, is a monopoly service provider and has considerable power, such as compulsory extraction of money and restricting freedom of movement, which may largely be exercised without the need for a Court order. Therefore, there is a need for robust checks and balances.

The combination of substantial power with poor effective governance will create the conditions for the abuse of power. This observation is not an indictment on the men and women who work at the ATO, but rather the observation that poor institutional environments will generate poor outcomes. As such it is unsurprising that the House of Representatives Standing Committee on Tax and Revenue heard instances of businesses collapsing, marriages ending, and even suicides resulting from ATO audits.¹² The Standing Committee's recommendation 5 is particularly damning:

The Committee recommends that the Australian Taxation Office only make allegations of fraud against taxpayers when evidence of fraud clearly exists.

¹⁰ Inspector general of Taxation, "Submission to the Tax Forum", (2011).

¹¹ Inspector General of Taxation, "The management of tax disputes", 2015.

¹² House of Representatives Standing Committee on Tax and Revenue, Tax Disputes, 2015.

Presumably that has not been past practice.

There have been other abuses too: In 2012 a Queensland couple were unable to dispute an ATO claim in the courts as the ATO had already bankrupted them. According to a report in the Australian Financial Review, “A Federal Court judge has raised the prospect of the commissioner of taxation “going to jail for contempt” after two taxpayers fighting the Australian Taxation Office were bankrupted because it took control of their remaining funds.”¹³

Governance at the ATO is so poor that it felt quite unconstrained by the courts. In the case, *Commissioner of Taxation v Indooroopilly Children Services (Qld) Pty Ltd*, at least two Federal judges were highly critical of the ATO’s conduct. Justice James Allsop:

I wish, however, to add some comments about the attitude apparently taken by, and some of the submissions of, the appellant. From the material that was put to the Full Court, it was open to conclude that the appellant was administering the relevant revenue statute in a way known to be contrary to how this Court had declared the meaning of that statute. Thus, taxpayers appeared to be in the position of seeing a superior court of record in the exercise of federal jurisdiction declaring the meaning and proper content of a law of the Parliament, but the executive branch of the government, in the form of the Australian Taxation Office, administering the statute in a manner contrary to the meaning and content as declared by the Court; that is, seeing the executive branch of government ignoring the views of the judicial branch of government in the administration of a law of the Parliament by the former. This should not have occurred.

As Justice Richard Edmonds has subsequently noted, “... a proposition such that the Commissioner [of Taxation] does not have to obey the law as declared by the courts until he gets a decision that he likes was astonishing ...”.¹⁴ Even more astonishing is that not a single ATO employee was prosecuted for contempt of court, nor is there any public record of any disciplinary action taken against any ATO employee following this judicial rebuke.

These criticisms of the ATO have been long-standing. John Howard voiced them in 2001:¹⁵

I’m not totally satisfied that the arrangements we had the in past adequately did that, that is one of the reasons why I said we’d appoint the position of Inspector General of the Tax Office and I will be specifically charging Senator Coonan with particular responsibility for seeing that there is an appropriate interaction between the Taxation Office and the business community, especially the small business community. It’s a difficult job tax administration but it’s also important that the lines of communication be open, it’s also important that the culture of the tax office not be as closed as it has been in the past, I have quite strong views on that. I respect the Tax Office but I do think it needs to have a rather more open culture and it’s very important that the relationship between the Tax Office and the business community be revitalised, that the Tax Office

¹³ Hannah Low, “ATO prevents couple making their case”, *The Australian Financial Review*, 6 February 2012.

¹⁴ Richard Edmonds, “Recent tax litigation: a view from the bench”, 2008.

¹⁵ John Howard, “Howard’s Press Conference Announcing Ministerial Arrangements”, 23 November 2001.

needs to reach out a little more and engage the business community and to understand that they do have legitimate concerns about the complexity of taxation law.

Those comments set the context for the establishment of the Inspector-General of Taxation. While the establishment of that office was a fine reform, the fact remains that criticisms of the ATO that were made 15 years ago remain criticisms being made today. To be fair, not all the blame can be laid at the ATO's door or on poor internal ATO governance:¹⁶

A leading Federal Court judge has criticised the federal government for drafting tax laws that focus on raising revenue and catching particular taxpayers, rather than basing them on sound, clear principles.

The result was “bloated and incoherent” tax laws that discouraged foreign investment, judge Michelle Gordon, one of the most highly respected tax judges in the nation, told a Tax Institute conference in Perth on Wednesday.

In the next section we set out our proposals for improved governance at the ATO. It is quite clear that simply imposing more bureaucracy will simply increase the governance burden without improving effective governance.

A Proposal for improved governance and control of the ATO

The role of the ATO can be described as follows: To raise revenue as authorised by the Australian Parliament subject to fair, equitable and lawful treatment of taxpayers in an effective and efficient manner. In practice, if criticisms of the ATO as set out in Inspector-General of Taxation reports and Parliamentary reports are correct, it appears that the ATO believes that its objective is to raise as much revenue as it can get away with. Our proposals are intended to remove perverse incentives for the ATO to maximise revenue collection in favour of raising that revenue as authorised by the Parliament and no more.

It is important to understand that revenue maximisation is inconsistent with the progressive taxation philosophy that underpins Australian taxation. The Parliament and Executive take great care and effort is setting tax scales and tax rates to ensure that the tax system is perceived as being fair and equitable. Much emphasis is made of people not paying too little taxation, but what is under-appreciated is that tax system fairness is also undermined when people pay too much tax. The ATO should have as a primary objective the lawful administration of the tax system ensuring that individuals neither pay too little tax or too much tax.

We have two sets of proposals:

- That civil and/or criminal liability be inserted into the Taxpayers' Charter and that those liabilities be enforced by a unit within the office of the Inspector-General of Taxation. Violations of the Taxpayers' Charter are an abuse of public office and there

¹⁶ Katie Walsh, “Tax laws bloated, incoherent: judge”, *The Australian Financial Review*, 14 March 2014.

need to be mechanisms to enforce the charter. The ATO has a lot of power relative to taxpayers. Specifically we propose that ATO officials be prosecuted or litigated in the ordinary courts for any failure to fully comply with the Taxpayers' Charter and that the Inspector-General of Taxation polices the Taxpayers' Charter.

- That a Board of Directors be appointed to have oversight of the ATO with the authority to monitor the performance of the ATO, maintain sound governance, and hire and fire ATO Commissioners. At present the ATO is not effectively accountable to any institution or organisation. It is undesirable to have the ATO directly accountable to the elected government of the day (due to the possibility, or more likely the perception, of democratic abuse). That, however, does not imply the current position is particularly desirable either. A Board that appointed by the government and/or the Parliament (or perhaps even elected) from a broad spectrum of taxpayers should have oversight of the ATO but importantly must have the ability to discipline the senior management of the ATO.

Being a tax-collector will never be a popular profession, but there is no reason why it should not be an honourable profession. Sound governance and the strict lawful treatment of taxpayers would make a positive contribution to certainty amongst taxpayers and improve the standards of tax collection in Australia. The principle being that tax collection should be certain. As Adam Smith has written: "The uncertainty of taxation encourages the insolence and favours the corruption of an order of men who are naturally unpopular, even where they are neither insolent nor corrupt".¹⁷

¹⁷ Adam Smith, "An inquiry into the nature and causes of the wealth on nations", 1776 [1976].

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