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The Parliament of the Commonwealth of Australia

# 2013 Annual Report of the Australian Taxation Office

## **First Report**

House of Representatives  
Standing Committee on Tax and Revenue

March 2014  
Canberra

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## Foreword

I am delighted to be associated with this inaugural report of the Standing Committee on Tax and Revenue. The Committee has hit the ground running, conducting an inquiry and tabling this report into the 2013 Annual Report of the Australian Taxation Office during the Autumn Sitzings.

Firstly, I wish to note the achievements of the Joint Committee of Public Accounts and Audit (JCPAA) in scrutinising tax administration. The JCPAA performed a scrutiny role on a recurrent basis between 2007 and 2013. It generally conducted a hearing or briefing with the Commissioner of Taxation and the ATO's scrutineers and stakeholders. The format developed by the JCPAA over that time has served as the template for this Committee's inaugural public hearing.

This inquiry has come at an opportune time for the Committee and for the ATO itself. The ATO has undergone significant change in senior management over the last two years, and new leadership has brought new aspirations for the ATO.

Commissioner Chris Jordan's goal of transforming the ATO into a contemporary service organisation that will handle most taxpayers' affairs seamlessly is admirable and should be pursued.

Fostering willing participation by simplifying taxpayer interaction serves two goals. It increases compliance (and, thus revenue collection), and also increases public support for the ATO.

I am optimistic about what can be achieved in simplifying taxpayer interaction through innovations such as pre-filling, and simplifying the online process for those with uncomplicated affairs. It is pleasing to see the ATO looking overseas to countries like Norway and Denmark for examples of best practice, and ways to improve the Australian system.

Streamlining tax administration and how taxpayers engage with the system should be seen as a priority.

Following on from previous work by the JCPAA, the Committee scrutinised the ATO on the tax gap. The ATO is researching international practice and consulting with the private sector with a view to developing a position later in the year. I look forward to the ATO providing further information to the Committee on this issue in the near future.

There was discussion at the hearing about the pros and cons of conducting random audits to develop a figure for the tax gap. The Committee considers random audits to potentially have a key role in developing a tax gap estimate, which can then be used as a key performance indicator by which the ATO can accurately monitor the tax gap and address it over time. Further, random audits are a means by which the ATO can assess the effectiveness of its risk assessment tools.

Budgetary pressures appear to be a challenge to the Commissioner's attempts to modernise the ATO. The Committee heard that staff reductions had already been planned due to a deteriorating budgetary position.

While budget reductions can deliver savings in the short term, this needs to be balanced against retaining the capacity necessary to achieve larger long-run benefits. Realising benefits in the future may require continued investment in the short term.

The ATO's determination to prioritise the revenue collection function in the face of staff reductions should be commended. It should remain the priority of the ATO to collect revenues due, within the absolute principle of fair treatment and respect to taxpayers.

Preserving revenue collection may force the ATO to reduce service standards, which is not ideal. Where possible, and with budget permitting, the ATO should continue to innovate and use information technology where possible to achieve efficiencies and improve existing service standards.

It was pleasing to see the ATO moving towards the position of the Inspector-General of Taxation by developing a process for an independent internal review of disputes at an early stage for large business and international taxpayers. Similarly, the ATO has also moved the role of deciding objections out of Compliance Group into the Legal Services and Design Group.

The ATO continues to receive positive feedback from its scrutineers. Further, the ATO has been proactive in responding to the Australian Public Service Commission's recent Capability Review, and has commenced implementing its recommendations. I am glad that the ATO readily undertook to keep the Committee up to date on its progress in responding to the review.


The Committee has requested that the ATO expressly address these issues, and other matters, in its submission for the next hearing in August. I look forward to working through these topics with the ATO in subsequent meetings.



Finally, I thank all witnesses, Committee members and the Secretariat for their assistance in the conduct of this public hearing and the preparation of this report.

John Alexander OAM, MP  
Chair





## Membership of the Committee

Chair            Mr John Alexander OAM

Deputy Chair   Dr Jim Chalmers

Members       Ms Terri Butler (from 18/3/14)

Mr Ian Goodenough

Mr Stephen Jones (to 18/3/14)

Ms Clare O'Neil

Mr Michael Sukkar

Mr Angus Taylor

Mr Bert van Manen

Mr Tim Watts

Mr Matt Williams

## Committee Secretariat

Secretary	Mr David Brunoro
Inquiry Secretary	Mr David Monk
Research Officers	Mr Shane Armstrong
Administrative Officers	Ms Tamara Palmer
	Mr Danny Miletic
	Ms Yvonne Lee
	Ms Antoinette Gardiner



## Terms of reference

Under Standing Order 215(c), the Committee is authorised to examine annual reports of agencies allocated to it by the Speaker. The Speaker's schedule of 10 December 2013 allocates the Australian Taxation Office, as well as other agencies, to the Committee.



## List of abbreviations

ADR	Alternative dispute resolution
APSC	Australian Public Service Commission
ATO	Australian Taxation Office
AVO	Australian Valuation Office
FTE	Full time equivalent
GST	Goods and Services Tax
ICT	Information and communications technology
JCPAA	Joint Committee of Public Accounts and Audit
OECD	Organisation for Economic Co-operation and Development
SES	Senior Executive Service

## Introduction

### Previous Parliamentary scrutiny of the Australian Taxation Office

- 1.1 Taxation and tax administration have long been a focus of Parliamentary scrutiny. A landmark inquiry was 1993's *An Assessment of Tax – An Inquiry into the Australian Taxation Office* conducted by the Joint Committee of Public Accounts and Audit (JCPAA).<sup>1</sup> The inquiry constituted a broad and comprehensive inquiry into tax administration and the new self-assessment system. The Committee made 148 recommendations, leading to the then Government announcing the Tax Law Improvement Project. A follow up inquiry was also conducted in 1995 to discuss progress of the Tax Law Improvement Project in more detail.<sup>2</sup>
- 1.2 In 2005 the JCPAA resolved to conduct a long term inquiry into administration of the tax system, culminating in 2008's report *Tax Administration*.<sup>3</sup>
- 1.3 Throughout the inquiry, the Committee met with the Commissioner of Taxation on a biannual basis, with the Committee noting the hearings ensured the ATO was held to account. The hearings also gave the ATO the opportunity to demonstrate to Parliament and the public that it operated to a high standard.
- 1.4 After the Committee tabled its report in 2008, it continued to hold biannual hearings with the Commissioner. The hearings were then

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1 Joint Committee of Public Accounts, Report No. 326, *An Assessment of Tax – A Report on an Inquiry into the Australian Taxation Office*.

2 Joint Committee of Public Accounts, Report No. 343, *Tax Law Improvement – A Watching Brief*.

3 Joint Committee of Public Accounts, Report No. 410, *Tax Administration*.

expanded to include other witnesses and held on an annual basis from 2012.

- 1.5 The process of conducting a hearing, involving scrutineers and stakeholders, making recommendations, and ensuring that recommendations are implemented by following up at the next public hearing created a cycle of continuous monitoring and improvement of tax administration.
- 1.6 The Standing Committee of Tax and Revenue hopes to build on the good work of the JCPAA by continuing the cycle of continuous monitoring and improvement, while also conducting other inquiries into tax and revenue.

## The report

- 1.7 The Committee's report is based on a public hearing held on 28 February 2014 at Parliament House, Canberra. Witnesses at the hearing included the Commissioner of Taxation, the Auditor-General, the Ombudsman and the Inspector-General of Taxation. One of the key themes at the hearing was the move to simplifying and streamlining the taxpayer experience, leading to a 'light or no-touch' engagement model for most taxpayers. A new engagement model has the potential to increase compliance whilst improving taxpayer confidence in the ATO and serving as a way to again make the ATO an innovator in tax administration.
- 1.8 The following appendices provide additional information:
  - Appendix A – Submissions
  - Appendix B – Public hearings
  - Appendix C – Exhibits
  - Appendix D – ATO Submission 4.1, *External Governance Arrangements*.
- 1.9 A copy of this report, transcripts of hearings and submissions are available on the Committee's website: [www.aph.gov.au/taxrev](http://www.aph.gov.au/taxrev).



## Inquiry into the 2012-13 Australian Taxation Office Annual Report

2.1 The following issues are considered in this chapter:

- Reinventing the ATO
- Small business and individual taxpayers
- The Tax Gap
- Policy and legal matters
- Staffing and service standards
- Independent review of ATO decisions
- Scrutiny of the ATO.

### Reinventing the ATO

#### Towards a contemporary service culture

2.2 In his opening statement, the Commissioner of Taxation outlined his vision of transforming and significantly improving the experience Australian individuals and companies have with the ATO, describing it as a 'reinvention', and an attempt to make it a contemporary service organisation.<sup>1</sup>

2.3 The Commissioner noted that the Australian tax system was complex, and as a result, there was the potential for mistakes to be made in administering the tax system. However, he wished for the ATO to have a culture that identified mistakes quickly, rectified them, learned from them, and treated taxpayers fairly and with respect.

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<sup>1</sup> Mr Chris Jordan AO, *Transcript of Evidence*, p. 1.

- 2.4 He said that the goal of the ATO was to ‘foster willing participation’, and that improving the taxpayer experience by simplifying interactions with the ATO was one way of achieving this goal.<sup>2</sup>
- 2.5 The Commissioner also touched on the role the ATO has with government, stating that it was the ATO’s goal to provide useful, insightful and relevant advice. He would also like to improve on what the ATO had offered in the past. Consultation was now more targeted, and focused on specific issues, and the number of consultative forums run by the ATO had been reduced from 68 to eight.<sup>3</sup>
- 2.6 The Commissioner also stated that the ATO executive had been ‘entirely refreshed’ and that three Commissioners had been appointed from outside the ATO. Further, the ATO’s upper management had also been decentralised. Its head of Corporate was based in Sydney, and its Chief Financial Officer was based in Melbourne.<sup>4</sup>
- 2.7 The Commissioner advised that he had observed a cultural tendency to try and eliminate, rather than manage risk at the ATO, and accordingly wished to instil a greater notion of risk management. To this end, he had recruited 19 senior audit managers from the private sector.<sup>5</sup>

## Simplifying and streamlining the taxpayer experience

- 2.8 The Committee heard more about the ATO’s goal for interaction with the community, and the ATO’s desire to improve the taxpayer experience. The Commissioner stated that 96 to 97 per cent of revenue collected was provided voluntarily, and that there was the desire to make the taxpayer experience easier for those with simple tax affairs.<sup>6</sup>
- 2.9 The Committee was advised that countries like Denmark and Norway were making taxpayer interaction with their respective tax offices far more simple:
- [Denmark] send 77 per cent of their tax returns to their citizens within two months of the end of the following year, completed. In Norway you do not have to do anything. If you do not respond, you are deemed to have lodged, with no more to do.<sup>7</sup>
- 2.10 The ATO advised that they were attempting to reorient tax administration with a view to simplifying processes, which should, in turn, make it easier

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2 Mr Chris Jordan AO, *Transcript of Evidence*, p. 2.

3 Mr Chris Jordan AO, *Transcript of Evidence*, p. 2.

4 Mr Chris Jordan AO, *Transcript of Evidence*, p. 2.

5 Mr Chris Jordan AO, *Transcript of Evidence*, p. 5.

6 Mr Chris Jordan AO, *Transcript of Evidence*, p. 8.

7 Mr Geoff Leeper, *Transcript of Evidence*, pp. 8-9.

to foster compliance. It was noted that a taxpayer with simple tax arrangements using e-tax still had to navigate through 140 screens to file their return.<sup>8</sup> In other words, e-tax was still reflecting its roots in the paper-based *Tax Pack*, rather than taking full advantage of what online services could offer to taxpayers.

- 2.11 The Committee heard that improvements in data collection concerning information on salary and wages, interest, dividends and Centrelink payments meant that information could be pre-filled into a taxpayer's return, making it easier for a taxpayer to complete their return.<sup>9</sup> This would then require a taxpayer with simple tax arrangements to only answer 'three to four simple questions about their deductions' before submitting a return.<sup>10</sup>
- 2.12 These innovations were being considered through the lens of the recent Australian Public Service Commission Capability Review of the ATO.

## Small business and individual taxpayers

### New developments for small business

- 2.13 The ATO outlined several new developments for small business over the last year:
- a mobile app
  - an after-hours call back service
  - an online business viability assessment tool to help manage cash flow and debts
  - industry benchmark information to allow businesses to compare themselves with their peers.<sup>11</sup>
- 2.14 The Committee noted the online business viability assessment tool, asking if information put into the program was used to provide an early warning about businesses at risk of insolvency.
- 2.15 The ATO replied that the tool analysed cash flow and debt management, and that the feedback received indicated that businesses and debtors found it useful. However, the tool did not collect data and provide it to the ATO, as its purpose was to assist small business.<sup>12</sup>

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8 Mr Geoff Leeper, *Transcript of Evidence*, p. 9.

9 Mr Chris Jordan AO, *Transcript of Evidence*, p. 8.

10 Mr Geoff Leeper, *Transcript of Evidence*, p. 9.

11 Australian Taxation Office, *Submission No. 4*, pp. 4-5

12 Mr Geoff Leeper, *Transcript of Evidence*, p. 24.

- 2.16 The Commissioner of Taxation advised that the tool had been developed by one of the 'big 4' accounting firms, and that the firm used it for its own assessment of business. He also noted that industry benchmark information had been provided to further assist small businesses.<sup>13</sup>

## Superannuation

- 2.17 The Committee asked about missing superannuation payments to employees determined by the ATO to be 'uneconomical' to collect, noting the ATO's Annual Report judged \$15m of outstanding superannuation debt to fall under this category.
- 2.18 The ATO advised that this would be a large number of small debts, and debt considered 'uneconomical to pursue' would likely be considered to be a small amount of money to an individual, being hundreds of dollars or less, not thousands. The ATO also suggested that it was likely that there had been attempts to collect these debts through mercantile debt agents.<sup>14</sup>
- 2.19 The Committee then asked about superannuation that had not been paid to employees due to a company entering insolvency. The ATO reported that its success in collecting these debts to employees had increased over the last five years.<sup>15</sup>
- 2.20 One of the factors that had driven policy action in this area over the last few years was the outcome of a 2010 review by the Inspector-General of Taxation into the ATO's administration of the Superannuation Guarantee Charge.<sup>16</sup> This contained a number of policy recommendations that were taken up by government.<sup>17</sup>

## Community outreach

- 2.21 The Committee asked the Commonwealth Ombudsman whether complaints to the ATO could be mitigated or reduced by the ATO engaging more with the community.
- 2.22 The Commonwealth Ombudsman replied that the ATO had an important role and that 'a good understanding by the community of the role of the office is critical.' However, the Ombudsman also stated that a cost-benefit analysis to determine the needs of the public was necessary:

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13 Mr Chris Jordan AO, *Transcript of Evidence*, p. 24.

14 Mr Geoff Leeper, *Transcript of Evidence*, p. 22.

15 Mr Neil Olesen, *Transcript of Evidence*, p. 23.

16 Inspector-General of Taxation, *Review into the ATO's administration of the Superannuation Guarantee Charge*, March 2010.

17 Mr Andrew McLoughlin, *Transcript of Evidence*, p. 23.

... one first of all has to engage in an appropriate cost-benefit analysis, because one would hope that a better understanding of what the role of the ATO might be in the community would make sure that the community is more understanding of the fact that the ATO is really only trying to do its job; it is not trying to make life difficult for the community. And of course the job that it does is critical to the fiscal stability of our country.<sup>18</sup>

- 2.23 The Commissioner of Taxation agreed that a cost-benefit analysis would be required, and that the ATO's challenge in dealing with the public was to ensure that the public's interactions with the ATO were 'infrequent, quick and painless.'<sup>19</sup>
- 2.24 He then outlined recent initiatives, noting that there was positive feedback from Non-English Speaking Background communities, and that YouTube information videos were now available in multiple languages, and that there was a desire to further expand that service.<sup>20</sup>
- 2.25 The Commissioner also noted the new mobile application for individual taxpayers, additional small business functionality, and a planned expansion into providing superannuation information. He indicated that public understanding of the tax system was one way to support compliance, and that simplified, relevant, targeted information was important.<sup>21</sup>
- 2.26 The ATO discussed the importance of information provided to schools for civics classes. It said that this information had been modernised, and take-up of the information by schools had increased 'quite significantly' over the last year.<sup>22</sup>
- 2.27 The ATO advised that it had a communications area that was responsible for monitoring communication and devising communication strategy, and that it used Facebook and Twitter to interact with taxpayers.<sup>23</sup>

## The tax gap

- 2.28 The ATO defines the tax gap as follows:

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18 Mr Colin Neave, *Transcript of Evidence*, p. 27.

19 Mr Chris Jordan AO, *Transcript of Evidence*, p. 27.

20 Mr Chris Jordan AO, *Transcript of Evidence*, p. 27.

21 Mr Chris Jordan AO, *Transcript of Evidence*, p. 27.

22 Mr Neil Olesen, *Transcript of Evidence*, p. 27.

23 Mr Geoff Leeper, *Transcript of Evidence*, p. 27.

The tax gap is the difference between the actual tax liability reported to us, or that we raise, and the tax liability that should be reported. That is to say, tax that would be reported assuming that all businesses and individuals fully complied with their tax-reporting obligations.

The tax gap is an estimate of the level of theoretical tax losses through non-reporting of tax by businesses through a failure to register or failure to lodge returns, net under-reporting of tax obligations or over-claiming of refunds.<sup>24</sup>

- 2.29 The Committee noted that the issue of attempting to measure the tax gap had been a previous topic of discussion when the ATO was scrutinised by the Joint Committee of Public Accounts and Audit, and it was identified by the ATO as an 'important element'<sup>25</sup> of measuring the overall effectiveness of a revenue agency.

## Current ATO action

- 2.30 The ATO has reported annually on the tax gap for the GST for some time.<sup>26</sup> The Committee asked the ATO to outline progress on examining the different methodologies used to measure the tax gap since the ATO last reported to the JCPAA in 2012. The ATO replied:

... we have invested quite heavily in the last two to three months in pulling together thinking internationally around estimates of tax gaps. We have looked at what a range of other countries are doing. We are drawing on OECD guidance and experience. We have also pulled together some private sector experts to help us with some advice about approaches on these methodologies. All of that work we hope will come together about April-May of this year with a view to us as an executive group considering what a sensible way forward is, taking into account all of the pros and cons of the advice that we get on the different methodologies.<sup>27</sup>

## Random audits and other methodologies

- 2.31 The ATO noted that, while there were several different methodologies available to calculate the tax gap, each had varying levels of confidence,
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24 Australian Taxation Office, *Tax Gap Overview*, [http://www.ato.gov.au/Business/Bus/Measuring-tax-gaps-in-Australia-for-the-goods-and-services-tax-\(GST\)-and-the-luxury-car-tax-\(LCT\)/?anchor=Tax\\_gap\\_overview#Tax\\_gap\\_overview](http://www.ato.gov.au/Business/Bus/Measuring-tax-gaps-in-Australia-for-the-goods-and-services-tax-(GST)-and-the-luxury-car-tax-(LCT)/?anchor=Tax_gap_overview#Tax_gap_overview) (accessed 7/3/14).

25 Mr Neil Olesen, *Transcript of Evidence*, p. 3.

26 Mr Neil Olesen, *Transcript of Evidence*, p. 3.

27 Mr Neil Olesen, *Transcript of Evidence*, p. 3.

and none were precise. The ATO's Second Commissioner, Compliance Group cautioned that by calculating a tax gap using any given methodology, the focus would be on the headline figure, rather than the confidence level surrounding that headline figure. He continued:

The confidence levels can be quite big, up to 80 per cent. If you have an estimate of a dollar, in fact the answer might be somewhere between nothing and \$2. It can be a very big range that you are talking about.<sup>28</sup>

2.32 The Inspector-General of Taxation put the alternative view. He agreed that while tax gap calculation was imprecise, it was a form of forecasting, and forecasting is never exact.<sup>29</sup>

2.33 The ATO stated that random audits supported a robust estimate of the tax gap, but that there were debates about the sample size required to generate a reliable estimate.<sup>30</sup>

2.34 The Inspector-General of Taxation advised the Committee that, while random audits contributed to a more reliable tax gap measurement, they also had the ability to uncover some taxpayers that a risk assessment tool might not, enabling the ATO to better assess risk. Further, they served as a way to measure the effectiveness of the ATO's risk assessment tools:

Whilst random audits do have benefits other than purely doing tax gap, you can use them to improve your risk assessment tools' performance and also to have a justification for using those risk assessment tools.<sup>31</sup>

2.35 While the Inspector-General did not have a firm position on implementing random audits, he thought it important that it be noted that 'random audits have a place', but that the financial costs to the ATO and the inconvenience to compliant taxpayers also had to be considered.<sup>32</sup>

2.36 The Deputy Inspector-General of Taxation stated that there were significant costs in the conduct of random audits, and they were also an inconvenience on compliant taxpayers. However, he suggested that 'compensating' these taxpayers may make random audits more palatable.<sup>33</sup>

2.37 The Commissioner of Taxation agreed that inconveniencing honest taxpayers by conducting random audits to generate a reliable sample in

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28 Mr Neil Olesen, *Transcript of Evidence*, p. 3.

29 Mr Ali Noroozi, *Transcript of Evidence*, p. 26.

30 Mr Neil Olesen, *Transcript of Evidence*, p. 3.

31 Mr Ali Noroozi, *Transcript of Evidence*, p. 26.

32 Mr Ali Noroozi, *Transcript of Evidence*, p. 26.

33 Mr Andrew McLoughlin, *Transcript of Evidence*, p. 26.

the thousands was an issue that had been ‘holding us back’ in the area of tax gap measurement.<sup>34</sup>

- 2.38 The Inspector-General of Taxation noted that many OECD countries did random audits, but that they generally took place at the high-wealth individual and small and medium enterprise level, rather than for major corporations, as revenue agencies generally had reliable information on publicly listed companies.<sup>35</sup>

## Policy and legal matters

### GST on low value imports

- 2.39 The Committee heard evidence on collection of GST on imports below the current \$1,000 threshold (‘low value’ imports). This issue had been the subject of inquiry by the Productivity Commission as part of its report into the Economic Structure and Performance of the Australian Retail Industry, and through the Low Value Parcel Processing Taskforce. The Commissioner of Taxation reported that the ATO had taken part in the taskforce, which also involved Treasury, Customs, Australia Post, the Department of Finance, and several other stakeholders. Advice on this issue was provided to the Government, and the issue would be a matter for the Council of Australian Governments.
- 2.40 The Commissioner advised that there was a cost/benefit trade-off on applying GST to low value imports, as foreign suppliers of goods were not required to register for GST, and the majority of low value imports cost less than \$100. Given those circumstances, the cost of collecting GST on these goods would be greater than the revenue realised.
- 2.41 The Committee inquired whether GST could be collected by merchant card services. The Commissioner replied that while it may be possible, merchants were not required to do so at this stage, and may have difficulty determining whether an item was subject to GST in Australia.<sup>36</sup>
- 2.42 Finally, the Commissioner noted the current process was reliant on the involvement of Customs, who contact the purchaser and arrange for GST to be paid. It should also be noted that goods are held by Australia Post until duty, taxes and charges are paid in full.<sup>37</sup> Extending this model for

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34 Mr Chris Jordan AO, *Transcript of Evidence*, p. 3.

35 Mr Ali Noroozi, *Transcript of Evidence*, p. 26.

36 Mr Chris Jordan AO, *Transcript of Evidence*, pp. 13-14.

37 Australian Customs and Border Protection Service, *Importing Goods by Post*, <http://www.customs.gov.au/site/page5653.asp> (accessed 7/3/14)



low value imports would have significant compliance and warehousing costs:

There are some real practical problems here. Australia Post says their warehouses just could not store it; their local post offices just could not store the volume of items. That is not a practical solution.<sup>38</sup>

## Section 25.90 of the *Income Tax Assessment Act 1997*

- 2.43 Section 25.90 of the *Income Tax Assessment Act 1997* (the Act) allows Australian companies to claim a deduction relating to foreign non-assessable non-exempt income.
- 2.44 The Committee drew the Commissioner's attention to a statement he made at Senate Estimates in June 2013, when he noted that section 25.90 of the Act was:
- ...the only provision in the tax act that specifically gives you an exemption against exempt income.<sup>39</sup>
- 2.45 The Commissioner was asked whether this was still the case, was it a problem, and was it an unnecessary distortion of tax law. He replied that it was his understanding that it was 'the only provision in the Act that specifically gives you a deduction against exempt income.'<sup>40</sup>
- 2.46 The ATO reported to the Committee that the matter was currently under consideration by government, and that Treasury was conducting a consultation on how a targeted integrity measure would prevent abuse of this section.
- 2.47 He gave the Committee background information on the provision, which was established in the early 2000s, and was designed to reduce compliance costs for Australian companies with overseas investments. He advised:
- People were doing things to make sure they did not have specific borrowings that related to that exempt income, because typically you do not get a deduction. That is still, I understand, the only provision in the Act that specifically gives you a deduction against exempt income.<sup>41</sup>
- 2.48 The Commissioner then described the change in taxpayer behaviour that resulted from the establishment of the provision:

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38 Mr Chris Jordan AO, *Transcript of Evidence*, p. 14.

39 Mr Chris Jordan AO, *Senate Economics Legislation Committee Estimates*, 5 June 2013, p. 139.

40 Mr Chris Jordan AO, *Transcript of Evidence*, p. 10.

41 Mr Chris Jordan AO, *Transcript of Evidence*, p. 10.

What happened, though, is that Australian companies that were owned by foreign companies who were mature and profitable and had high taxable incomes here in Australia moved things around within their international groups that effectively dumped debt here in Australia – they created debt. At the same time these provisions were brought in... ..a set of provisions called debt creation provisions went. Had they still been there, they would have been the integrity measure that would have stopped international groups, because what effectively happened was that there was no change in the economic circumstances of the international group. All that happened was that the ownership of some other operation was put underneath the Australian company.<sup>42</sup>

- 2.49 The Commissioner noted that it was difficult to use part IVA of the *Income Tax Assessment Act 1997* (the general anti-avoidance provision) to prevent this from happening, because the exemption was explicitly written into the legislation. He advised that the consultation process currently underway was trying to find a way to maintain the original intent of section 25.90 of the Act while preventing foreign companies transferring their debt to Australia, which ‘in some cases eliminated if not all virtually all of the Australian tax being payable by some foreign-owned companies.’<sup>43</sup>
- 2.50 The Committee asked what the latest assessment of cost of this exemption was, with the Commissioner agreeing that it was in the hundreds of millions of dollars.<sup>44</sup>

## Recent litigation

- 2.51 The Committee asked about the process behind the ATO’s decision not to appeal to the High Court after losing an appeal in the full Federal Court in a case relating to the tax liability of NewsCorp. The case involved a 1989 restructure within the organisation, and constituted a potential \$880m tax liability for the company.
- 2.52 The Commissioner of Taxation advised that advice from senior and junior counsel was that there was little likelihood of success in obtaining a special leave application in the High Court, and that this was often the case for the ATO. He advised the Committee that a Minute that did not contain a request for ministerial action (that is, for information only) was

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42 Mr Chris Jordan AO, *Transcript of Evidence*, p. 10.

43 Mr Chris Jordan AO, *Transcript of Evidence*, p. 10.

44 Mr Chris Jordan AO, *Transcript of Evidence*, p. 10.

- sent to the then Assistant Treasurer (Hon. David Bradbury MP), advising the Minister of the outcome, and that there was no response from the Minister's office.<sup>45</sup>
- 2.53 The Commissioner was asked whether the ATO would generally negotiate on an amount to be repaid in the case of a potential tax liability of similar magnitude. He replied that there were generally payment arrangements in similar cases, and if the taxpayer paid 50 per cent of the tax payable, no interest would accrue on the entire amount until the dispute was resolved.<sup>46</sup>
- 2.54 The Commissioner noted, however, that litigation risks were taken into account, and that the ATO could negotiate down the amount of tax payable to avoid taking a matter to court that contained a significant level of risk.<sup>47</sup>
- 2.55 Regarding the case mentioned in the hearing, the Commissioner noted that it related to the 2002 income year, with the ATO also adding that the provisions relevant to the case had been repealed in 2003.<sup>48</sup>
- 2.56 Finally, the Commissioner informed the Committee that reducing the time taken to resolve areas of dispute between the ATO and taxpayers, and clearing the backlog of disputes and litigation, was an area of focus under his leadership.<sup>49</sup>

## Staffing and service standards

### Staffing reductions

- 2.57 The Committee noted the ATO announcement of November 2013 that there would be 900 redundancies made as a result of efficiency dividends, a planned reduction in the size of the public service and the abolition of some taxes. The Committee asked about the status of the redundancy program. The ATO replied that they had identified the need to reduce staffing by 900 Full Time Equivalent (FTE). More than 500 staff members had applied for the 500 voluntary redundancies, which constituted an oversubscription, and that the ATO would soon assess these applications.<sup>50</sup>

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45 Mr Chris Jordan AO, *Transcript of Evidence*, p. 6.

46 Mr Chris Jordan AO, *Transcript of Evidence*, p. 6.

47 Mr Chris Jordan AO, *Transcript of Evidence*, p. 6.

48 Ms Alison Lendon, *Transcript of Evidence*, p. 7.

49 Mr Chris Jordan AO, *Transcript of Evidence*, p. 6.

50 Mr Geoff Leeper, *Transcript of Evidence*, pp. 10-11.

- 2.58 The Committee inquired as to the drivers of the job reduction program, asking where the reductions in budget had come from. The Commissioner replied:

Decisions made by the previous government and decisions made or announced by the present government have contributed to the change in our forward resourcing. It is about \$600 million over the forward estimates period, just over half of which is attributable to decisions of the previous government and just under half of which is issues such as the closure of the AVO, the announcement of the future of the Australian Charities and Not-for-profits Commission and the abolition of the minerals resource rent tax. While some of those things are announced but not yet through the parliament, our planning has to take account of the possibility that they occur.<sup>51</sup>

## Regional offices

- 2.59 The Committee asked about the potential effect these staff reductions would have on services in regional areas, with the ATO replying that there were approximately 80 staff in small regional offices at this point in time.
- 2.60 The ATO was currently reviewing its leases in regional areas, and determining whether an ATO footprint was still required, or whether the ATO could retain a staffing presence without leasing specific premises. The ATO was considering allowing staff to work from home or co-locate in other Commonwealth premises.<sup>52</sup>
- 2.61 The Commissioner of Taxation indicated that there was no plan for the ATO to leave major regional centres like Wollongong, Newcastle, Albury-Wodonga, Townsville, or Geelong.<sup>53</sup>

## Revenue collection

- 2.62 The Committee expressed concern that staffing reductions would affect revenue collections or customer service. The Commissioner said that while he could make no guarantees, he provided 'an assurance' that the core function of revenue collection would be protected, but that he could not say there would not be any other impact on ATO operations.<sup>54</sup>

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51 Mr Chris Jordan AO, *Transcript of Evidence*, p. 22.

52 Mr Geoff Leeper, *Transcript of Evidence*, p. 11.

53 Mr Chris Jordan AO, *Transcript of Evidence*, p. 11.

54 Mr Chris Jordan AO, *Transcript of Evidence*, p. 20.

2.63 He stated:

The two main principles that we will be using... ..are that we must, above all things, protect revenue collections and, as far as we can, protect service standards. So we will be looking hard at back office functions, at layers of management, at areas where we might have more than one team doing something where we can achieve efficiencies. That is work that we have to do between here and the end of the year when people will exit. At this stage I cannot quantify for you whether there would be an impact on revenue. Our intention is that there will not be, because that would be the first thing we would protect. If you cut down to a certain level, it is inevitable that at some point either customer service standards and/or revenue collections would be impacted upon.<sup>55</sup>

2.64 Regarding revenue collection, the ATO noted that 96 per cent of tax revenue was provided voluntarily, while compliance, a significant part of the organisation, pursued the other four per cent. Current efforts were to focus on high-risk areas where there was a higher rate of return of revenue. He noted that staff reductions a 'little beyond' the planned reduction of 900 FTE positions may lead to a reduced ability to pursue revenue from compliance activities.<sup>56</sup>

2.65 The Commissioner called for a focus on maintaining revenue collection as the core function of the ATO, and noted it was difficult to determine at what point staff reductions would start to affect revenue collection.<sup>57</sup>

## Service Standards

2.66 The Commissioner indicated that there may be a reduction in service standards. He stated that, while the current service standard is that 80 per cent of calls to the ATO will be answered within five minutes, the standard may have to change, and the ATO would have to make choices in this area. However, he also advised that the ATO was attempting to 'de-layer' and 'take out some of the middle management that was there because of the process itself'.<sup>58</sup>

2.67 The Committee asked whether the Commissioner's cultural change program was at risk because of staff reductions. The Commissioner replied that cultural change would be harder, but still achievable:

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55 Mr Chris Jordan AO, *Transcript of Evidence*, p. 11.

56 Mr Geoff Leeper, *Transcript of Evidence*, p. 12.

57 Mr Chris Jordan AO, *Transcript of Evidence*, p. 12.

58 Mr Chris Jordan AO, *Transcript of Evidence*, p. 20.

I cannot deny that this is making it harder. So, yes, this will make cultural change more difficult. Change in itself is often difficult for people to deal with. It is often something where you have got to be very careful in the way that you manage, communicate and achieve that change. In an uncertain environment, in an environment in which our budgets are being reduced, that will probably make the pace of change slower and might make the ambitious nature of some of our change program less easy to implement over time. It is a long-term process, though.<sup>59</sup>

## New efficiencies and best practice

- 2.68 The Committee heard that innovations in technology were playing a part in driving efficiency, with the ATO providing the following example:

From May this year, we will invite taxpayers to record a voice print with which they can identify themselves to our contact centres. That saves 45 seconds each time that person contacts us. That does not sound like much, but that is 100 FTE across our call load for the entire year. So, when there is enough customer take-up of that, I can either take that 100 FTE as a resource dividend or improve the service standard; and that is a choice that we will make in the context of our budget. So we are not sitting still waiting for the heavens to fall; we are innovating and trying to restructure our business in such a way that we can achieve effective taxpayer service and maintain revenue collection to the maximum degree possible.<sup>60</sup>

- 2.69 The Committee also heard that innovations like e-tax for Mac had a take-up of 300,000 last year, and that there was a 33 per cent reduction in paper lodgements from 600,000 to 400,000. Paper returns were all scanned or keyed, requiring 'armies of people'. Lodgements via e-tax were far more efficient, as information came into the core processing system 'clean', enabling rapid processing.<sup>61</sup> A reduction in paper lodgements had the potential to reduce the need for staff in this processing area.

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59 Mr Chris Jordan AO, *Transcript of Evidence*, p. 20.

60 Mr Geoff Leeper, *Transcript of Evidence*, p. 13.

61 Mr Geoff Leeper, *Transcript of Evidence*, pp. 14-15.

## Internal review of ATO decisions

### Background

- 2.70 A dispute between a taxpayer and the ATO can go through a number of processes. For example, the ATO may conduct a review 'to investigate inconsistencies or risks about some activities, transactions or industries and try to confirm the risks.' A review may lead to an audit or the ATO may proceed directly to audit, which is designed 'to find, measure and correct errors.' A key stage in the audit is the position paper, where the audit team formally outline their views on a matter. Both processes can be used to encourage a taxpayer to make a voluntary disclosure and both may ultimately lead to the ATO amending an assessment.<sup>62</sup>
- 2.71 If the taxpayer is not satisfied with how these processes are occurring, they may seek to discuss or negotiate the matter with the ATO informally. However, once a decision is made, or the ATO issues an assessment, then the *Taxation Administration Act 1953* requires the taxpayer to make a formal objection, which the ATO will then consider. If the taxpayer is still not satisfied with the outcome, then they may seek to have the matter reviewed by the Administrative Appeals Tribunal, or in some cases, they can proceed directly to the Federal Court.
- 2.72 At any stage during these processes, the parties can agree to have the matter undergo some type of alternative dispute resolution (ADR), such as mediation, where a third party assists the parties to negotiate a settlement. As a government agency, the ATO is bound by the model litigant rules, which require it 'only to start court proceedings if it has considered other methods of dispute resolution (eg alternative dispute resolution or settlement negotiations).'<sup>63</sup> In a recent review, the Inspector-General of Taxation concluded that the ATO could make better use of ADR. This was based on the statistic that only 10 per cent of cases lodged in the Administrative Appeals Tribunal in the three years to June 2011 proceeded to finalisation. A high number of cases were discontinued because the Tribunal's case conferences encouraged the parties to work through the issues and gain a better understanding of the likely outcomes of proceedings.<sup>64</sup>

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62 Australian Taxation Office, 'How we check compliance: Audits and reviews' at <http://www.ato.gov.au/General/How-we-check-compliance/In-detail/Cash-economy/Support-for-business/Correcting-your-tax-return-or-activity-statement/?page=9> accessed 18/3/14.

63 *Legal Services Directions 2005*, Appendix B, cl. 5.1.

64 Inspector-General of Taxation - Review into the ATO's Use of Early and Alternative Dispute Resolution, pp. 38-39,

2.73 The Inspector-General of Taxation finalised a review into objections in 2009. One of the issues that came up during this review was taxpayer perceptions of a lack of independence in how the ATO managed objections. The Inspector-General summarised this as follows:

... stakeholders expressed concern about the perceived lack of independence in the objections process where an ATO objection officer is located within the same business line as the original decision maker, albeit in a different section. This has led to certain stakeholder concerns that there is a perception of bias in the resolution of objections and that the process was merely formality before the matter progressed to the AAT or Federal Court.

The IGT found that in relatively simple matters, there was a greater degree of independence with objections officers having more of an appreciation of their role and the role of the original decision maker. However, in larger more complex cases these respective roles and responsibilities became blurred. This was partly due to the complexity of the facts or the relevant law and ATO's scarce technical resources.<sup>65</sup>

2.74 The recommendations in the report suggested some ways in which to improve the process around objections. For example, where an objection officer is likely to disallow an objection, and they sought advice or input from the original decision maker, then the taxpayer should be given the opportunity to speak to the decision maker to rebut the ATO view.<sup>66</sup>

2.75 At the hearing, the Inspector-General discussed this report. He advised that taxpayers expected a review be independent as possible at the objection stage, but that this did not always occur. Instead, in some instances, the objection officer was junior to the original decision maker, and there was the perception that there was insufficient separation.<sup>67</sup>

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([http://www.igt.gov.au/content/reports/ATO\\_alternative\\_dispute\\_resolution/ADR\\_Report\\_Consolidated.pdf](http://www.igt.gov.au/content/reports/ATO_alternative_dispute_resolution/ADR_Report_Consolidated.pdf)) (accessed 17/3/14).

65 Inspector-General of Taxation – Review into the ATO's Use of Early and Alternative Dispute Resolution, p. 100,

([http://www.igt.gov.au/content/reports/ATO\\_alternative\\_dispute\\_resolution/ADR\\_Report\\_Consolidated.pdf](http://www.igt.gov.au/content/reports/ATO_alternative_dispute_resolution/ADR_Report_Consolidated.pdf)) (accessed 17/3/14).

66 Inspector-General of Taxation – Review into the underlying causes and the management of objections to Tax Office decisions, p. 14,

([http://www.igt.gov.au/content/reports/underlying\\_causes/underlying\\_causes.pdf](http://www.igt.gov.au/content/reports/underlying_causes/underlying_causes.pdf)) (accessed 17/3/14).

67 Mr Ali Noroozi, *Transcript of Evidence*, p. 29.



- 2.76 The Inspector-General went further in 2011. At the Tax Forum, he argued that there should be a separate appeals area in the ATO, headed by a new Second Commissioner.<sup>68</sup>
- 2.77 Subsequently, he made a similar recommendation in his May 2012 Review into the Australian Taxation Office's use of early and alternative dispute resolution. As an interim measure, the Inspector-General recommended that the ATO conduct a pilot for the most complex cases. His suggestion was that the law group would manage the objections and litigation for these matters, including deciding whether they would be litigated. The Inspector-General also recommended that communications between the compliance and legal teams only take place with the taxpayer's consent.<sup>69</sup>
- 2.78 This recommendation was not agreed to by the previous Commissioner of Taxation, who indicated that the appointment of a new Second Commissioner was a matter for the Government, and that trialling such an appeals area would be costly.

## ATO reforms

- 2.79 The ATO has conducted a number of reforms in response to the Inspector-General's scrutiny. In 2012, the ATO commenced a review process for large businesses where a taxpayer did not agree with the ATO's final audit position, before the issue of an amended assessment.<sup>70</sup> Two further reforms were commenced from July 2013. Both were related to the creation of the new Review and Dispute Resolution area, located in the Law Design and Practice Group.<sup>71</sup>
- 2.80 The first of these is the recasting of the 'independent review process' for income tax for large business and international taxpayers. Importantly, it will enable disputes with the taxpayers to be examined by a 'fresh set of eyes' in the Review and Dispute Resolution area. The initial narrow focus allowed the ATO to review the process after six months.<sup>72</sup>
- 2.81 These reviews occur at the request of the taxpayer during the audit phase, after the issue of the initial position paper. If the audit team disagrees with

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68 Mr Ali Noroozi, *Transcript of Evidence*, p. 18.

69 Inspector-General of Taxation - Review into the ATO's Use of Early and Alternative Dispute Resolution ([http://www.igt.gov.au/content/reports/ATO\\_alternative\\_dispute\\_resolution/ADR\\_Report\\_Consolidated.pdf](http://www.igt.gov.au/content/reports/ATO_alternative_dispute_resolution/ADR_Report_Consolidated.pdf)) (accessed 7/3/14).

70 Mr Chris Jordan AO, 'Tax, the way ahead,' speech to the Tax Institute 28th Annual Convention, Perth, 14 March 2013 <http://www.ato.gov.au/Media-centre/Speeches/Commissioner/Tax,-the-way-ahead/> (accessed 18/3/14).

71 Mr Chris Jordan AO, *Transcript of Evidence*, p. 19.

72 Mr Neil Olesen, *Transcript of Evidence*, p. 18.

the result, they can in effect 'appeal' to a more senior officer in the Review and Dispute Resolution area, who will consult further with the business line and make the final decision.

2.82 However, there are restrictions. Neither party is allowed to introduce new information during this stage. Further, some items are excluded, such as the general anti-avoidance provisions. In addition, a taxpayer will only have one opportunity to request an independent review for each draft position paper. Therefore, at the issue of a position paper, the taxpayer will need to decide whether they will introduce new information or request the independent review.<sup>73</sup>

2.83 The Commissioner of Taxation advised that one of the drivers of the independent review process was the time taken to resolve disputes:

Part of the problem with these large audits in particular is that there are significant issues, and people do get in their own trenches – that happens on both sides – and there is a bit of a paper wall that goes on with position papers and amended position papers – 'Here's a QC's opinion; here are two back in return' – and on it goes over the years.<sup>74</sup>

2.84 The second reform was to transfer the objections function from the Compliance Group to the Law Design and Practice Group.<sup>75</sup>

2.85 The Committee asked the Inspector-General of Taxation and the Ombudsman whether many complaints had been raised over the objection and compliance areas being in the same business line, with the Inspector-General replying that it had 'not been raised that often', and that the main issue was that taxpayers wanted a review to be 'as independent as possible'.<sup>76</sup> The Ombudsman indicated that they had not received many complaints from people on this issue.<sup>77</sup>

## Pros and cons of the new system

2.86 The Committee heard about the pros and cons of the new review mechanism. The Commissioner advised that there had been 10 reviews

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73 Maddocks, 'Tax Disputes and Seeking and Independent Review: What are the Pitfalls and How to Avoid Them,' <http://www.maddocks.com.au/reading-room/a/tax-disputes-and-seeking-an-independent-review-what-are-the-pitfalls-and-how-to-avoid-them> (accessed 15/3/14).

74 Mr Chris Jordan AO, *Transcript of Evidence*, p. 5.

75 Mr Chris Jordan AO, *Transcript of Evidence*, p. 29.

76 Mr Ali Noroozi, *Transcript of Evidence*, p. 30.

77 Mr Colin Neave, *Transcript of Evidence*, p. 31.

undertaken over the first six months, with four resolved in the taxpayer's favour and closed.<sup>78</sup>

- 2.87 The Inspector-General identified one significant problem with the independent review function as it currently operated, in that its relationship with formal objections (which occur later) is not settled:

The way it differs to what I suggested is that the legislation is set up, the assessment is issued and then you object to that. There are a number of issues of difference, and I will outline them as best I can. One of them is that this independent review function happens before the objection stage; so the taxpayer is still entitled to object at the objection time. There are two possible scenarios: one is that when you have had somebody very senior look at it as an independent review, what can then be added on at the objection stage? Is it then purely a rubber stamp, and would that be valid under the legislation? If it is not a rubber stamp, then we have introduced a third layer effectively. Those are some of the issues that I would raise. But I have not made a big issue of it because this was a pilot – something to learn from before they rolled it out.<sup>79</sup>

- 2.88 The Commissioner replied that the objection could be based on the independent review:

So we will have an independent review done by a senior person in the organisation, typically from the tax counsel network that sits in the review and disputes group under law design and practice. If the objection is done, it is effectively a third layer because you have the compliance group doing it, you have the independent review and then you would have a third group. I cannot see the necessity. It would be a pretty straight forward process if the objection is on all fours with the independent review and there is not new material or anything like that. It could be a very straightforward process to deal with that objection because it has already been dealt with by the highest-level independent people that we would have available in the organisation.<sup>80</sup>

- 2.89 The Inspector-General noted the current objection and independent review structure did not 'sit neatly', and that consideration of how the new process worked alongside legislation may need to take place.<sup>81</sup>

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78 Mr Chris Jordan AO, *Transcript of Evidence*, p. 5.

79 Mr Ali Noroozi, *Transcript of Evidence*, p. 19.

80 Mr Chris Jordan AO, *Transcript of Evidence*, p. 19.

81 Mr Ali Noroozi, *Transcript of Evidence*, p. 19.

## A separate disputes body?

2.90 The Commissioner of Taxation expressed caution in establishing a dispute body completely separate from the ATO:

If you do set up an independent body to do that then what work will they be doing? They will just be looking at the prosecution of matters. They will just be seeing the worst of the behaviour of taxpayers, and that in itself will simply build up a culture over time.<sup>82</sup>

2.91 The Commissioner suggested this would not be as much of a problem under the current system, due to staff rotation:

I think we have to look at changing the culture within the ATO and being able to refresh people and rotate people through as well. We offer a fairly broad-based career path for people. I am not sure what an agency that just prosecuted tax cases would look like after 10 years, because that could involve its own cultural issues. Yes, you would sever it from the ATO, but what would it look like? How would it attract people? What sort of career path would it offer in its own isolated existence?<sup>83</sup>

2.92 The Inspector-General of Taxation agreed that a disputes function should be retained within the ATO for the sake of efficiency, as 'the dispute cycle might be much longer' if this responsibility was moved to an external body, and that a process as independent as possible within the ATO 'would be the way to go'.<sup>84</sup>

## Moving forward

2.93 The Committee asked about the outcomes of the trial or pilot of the independent review process. The ATO reported that feedback had been received from the 10 taxpayers who had gone through the process, and that it had been 'very positive', and that suggestions made by taxpayers were being incorporated into the new process.<sup>85</sup>

2.94 The Inspector-General of Taxation indicated that most of the feedback his office had received on the function had been largely positive.<sup>86</sup>

2.95 The ATO advised that its Executive had recently considered the outcomes of the trial, and agreed to extend the reviews to GST. Other

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82 Mr Chris Jordan AO, *Transcript of Evidence*, p. 29.

83 Mr Chris Jordan AO, *Transcript of Evidence*, p. 29.

84 Mr Ali Noroozi, *Transcript of Evidence*, p. 29.

85 Mr Neil Olesen, *Transcript of Evidence*, p. 18.

86 Mr Ali Noroozi, *Transcript of Evidence*, p. 30.

recommendations were also accepted, including those about processes for escalating matters within the ATO.<sup>87</sup>

- 2.96 The Commissioner indicated that he would consider 'cascading' the independent review function to other taxpayers but, given the process was intensive and required high levels of technical expertise, there would be resourcing issues.<sup>88</sup>
- 2.97 Considering the new program underway at the ATO, the Inspector-General of Taxation believed that the process should be given time to become established before it could be properly judged.<sup>89</sup>

## Scrutiny of the ATO

- 2.98 All three scrutiny bodies were positive in their assessment of the ATO, consistent with the assessments provided to the Joint Committee of Public Accounts and Audit in previous years.
- 2.99 The Auditor-General noted in his statement to the Committee that the ATO was broadly well-managed, well-governed, and responsive to the requests of the Australian National Audit Office. However, the Auditor-General cautioned that the ATO's recent changes in governance, resource pressures and staffing reductions would be kept under review by his office.<sup>90</sup>
- 2.100 The Inspector-General of Taxation gave the Committee an overview of his review reports. The Assistant Treasurer recently released three reports. One of them covered the ATO's risk assessment tools, and the Inspector-General stated that he developed a checklist for designing future tools. Another covered data matching, in which the Inspector-General concluded that it was generally effective in identifying omitted income.<sup>91</sup> The third report covered the income tax refund integrity program. A few years ago, there had been delays in processing returns and refunds. The Inspector-General stated that 'there had been considerable improvements

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87 Mr Neil Olesen, *Transcript of Evidence*, p. 18.

88 Mr Chris Jordan AO, *Transcript of Evidence*, p. 29.

89 Mr Ali Noroozi, *Transcript of Evidence*, p. 30.

90 Mr Ian McPhee PSM, *Transcript of Evidence*, p. 17.

91 Inspector-General of Taxation – Review into the Australian Taxation Office's compliance approach to individual taxpayers – use of data matching, p. vii, ([http://www.igt.gov.au/content/reports/ATO\\_data\\_matching/ATO\\_Data\\_Matching\\_with\\_Cover.pdf](http://www.igt.gov.au/content/reports/ATO_data_matching/ATO_Data_Matching_with_Cover.pdf)) (accessed 18/3/14).

after the initial round of issues.’ All reports made recommendations for improvements.<sup>92</sup>

- 2.101 The Commonwealth Ombudsman indicated that while the ATO had remained the third highest source of agency complaint in the last financial year, there had been a 35 per cent reduction in complaints in the year to date.<sup>93</sup>
- 2.102 The Ombudsman attributed this to an improvement in ATO communication with taxpayers during tax time. He believed that feedback from his office may have contributed to this outcome. He also reported that steps had been taken to ensure that taxpayers were aware that the first place a complaint should be taken was the ATO, and that the Ombudsman’s role was to be a safety net, a helper and an adviser.<sup>94</sup>
- 2.103 The submission from the Commonwealth Ombudsman noted that the majority of complaints about the ATO are now remedied through the provision of a better explanation to the complainant. There has been a steady rise in this statistic for the last three years, from 34 per cent in 2010-11 to 55 per cent in 2012-13.<sup>95</sup>
- 2.104 The Ombudsman suggests this increase has been partially due to what is now known as the ‘Second Chance Transfer’. This mechanism allows the Ombudsman to refer a complaint about ATO administration considered final (by the ATO) back to the ATO if the Ombudsman identified an issue that could easily be resolved by the ATO (essentially giving the ATO a second chance to resolve an issue).<sup>96</sup>
- 2.105 This Second Chance Transfer has allowed for quicker resolution of issues for taxpayers than if the Ombudsman conducts his own investigation, and allowed for the ATO to learn from complaints and improve its complaint handling practices.
- 2.106 The Ombudsman advised that the Second Chance Transfer was effective because it placed the onus on the ATO to identify what it could have done better and to contact the complainant within agreed timeframes. This changed the dynamic so that the complainant no longer feels they have to pursue the ATO to persuade it about the validity of their concerns.<sup>97</sup>
- 2.107 While the Ombudsman was pleased to note that complaints about delays had been trending down, delays remained a common cause of complaint.
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92 Mr Ali Noroozi, *Transcript of Evidence*, pp. 16-17.

93 Mr Colin Neave, *Transcript of Evidence*, p. 17.

94 Mr Colin Neave, *Transcript of Evidence*, p. 17.

95 Commonwealth Ombudsman, *Submission No. 1*, p. 3.

96 Commonwealth Ombudsman, *Submission No. 1*, p. 3.

97 Mr Colin Neave, *Transcript of Evidence*, p. 17.

He also reported that his office had provided feedback to the ATO that it needed to communicate better with taxpayers when there were system errors and outages.<sup>98</sup>

- 2.108 Finally, the Ombudsman reported that he was currently conducting an own-motion investigation into complaint handling in all government agencies, including the ATO. His office had also contributed to the ATO's recent self-directed audit into its management of complaints and other feedback.<sup>99</sup>

## Australian Public Service Commission Capability Review

- 2.109 The Committee noted that the ATO had been the recent subject of an Australian Public Service Commission (APSC) capability review. In 2010, the Department of Prime Minister and Cabinet released *Ahead of the Game: Blueprint for the Reform of Australian Government Administration*. It recommended that the APSC assess the capability in key agencies. The aim is to raise the capability of key agencies, as well as the public service overall.<sup>100</sup> The agencies scheduled for review are all the departments of state, as well as three others: the ATO, the Australian Bureau of Statistics, and the Australian Customs and Border Protection Service.
- 2.110 The leaders for each review comprise three people with extensive public and private sector experience; two are external to the public service and one is a serving high-level SES officer seconded from another agency. A small team of Commission officers and a secondee from the reviewed agency provide support. Reviews are conducted in partnership with agencies. Following reviews, agencies develop and implement action plans and the Commission undertakes a smaller follow-up review (a health check) to identify what improvements have occurred.
- 2.111 Fieldwork for the ATO's review was conducted between January and May 2013. The Commission finalised the report in May 2013 and the Government released it in December 2013.
- 2.112 The ATO's capability review found that it has a strong track record in implementing new tax law and managing the tax and superannuation systems. It also found that the ATO has historically been a world leader in tax administration with many innovations. However, its pace of

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98 Mr Colin Neave, *Transcript of Evidence*, p. 17.

99 Mr Colin Neave, *Transcript of Evidence*, p. 17.

100 Australian Public Service Commission, *Capability Review: Australian Taxation Office*, May 2013, p. v.

innovation had started to slow and tax administrations in other countries were overtaking it, especially in electronic services.<sup>101</sup>

2.113 The ATO is in need of transformational change.<sup>102</sup> The review summarised its culture as follows:

The prevailing culture in the ATO is one of collaboration, professionalism, technical accuracy and integrity of process. When taken to the extreme, this culture results in what review participants almost universally described as risk aversion. A cultural predisposition to avoid rather than appropriately manage risk manifests as:

- elevation of decision making
- protracted processes of internal consultation and debate that delay outcomes
- a feeling of disempowerment at all levels
- perceived lack of support for staff if a mistake is made.<sup>103</sup>

2.114 This assessment is consistent with much of the discussion at the hearing about the need for the ATO to manage risk, rather than try to eliminate it. It is also consistent with the Commissioner's drive to simplify the taxpayer experience through better online services and the 'light or no-touch' engagement model.

2.115 The APSC identified five key priority areas for the ATO to address.

2.116 The first priority area is for the ATO to develop a forward-looking, enterprise-wide strategy. At the hearing, the ATO stated that feedback from the APSC was that the ATO was too focused on the shorter-term – from 12 to 18 months, and that this focus should be extended. The ATO reported that their focus for strategic planning was 2020, and that there were plans to formally launch its strategic plan and strategy in the coming month.<sup>104</sup>

2.117 The second priority area is for the ATO to better develop its ICT efficiency and agility. In the report, the APSC found that 74 per cent of its ICT budget for 2012-13 was allocated to running costs and maintenance, 22 per cent was allocated to non-discretionary new work (government policy and legislative change), and only 4 per cent allocated to discretionary work

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101 Australian Public Service Commission, *Capability Review: Australian Taxation Office*, May 2013, pp. 5-6.

102 Australian Public Service Commission, *Capability Review: Australian Taxation Office*, May 2013, p. 5.

103 Australian Public Service Commission, *Capability Review: Australian Taxation Office*, May 2013, pp. 6-7.

104 Mr Geoff Leeper, *Transcript of Evidence*, p. 7.



that could support innovations that would simplify the system for taxpayers.

- 2.118 Discretionary work was mainly driven by bottom-up proposals, with less consideration of how they benefited the ATO overall. The ATO is now looking to ‘rebalance from maintenance into change – so, to put more effort into changing and improving our systems.’<sup>105</sup>
- 2.119 The third priority area covered cultural change. The ATO stated that it was looking to drive this ‘through a range of leaders and managers to make sure the staff at the front line understand the mission and purpose of the organisation.’<sup>106</sup>
- 2.120 The fourth area was internal governance. The review noted that the ATO had ‘invested heavily’ in its internal governance framework but that the ATO needed to ensure that it was fit for purpose and assisted staff in managing risk. For example, the review found that practice statements and instructions were too elaborate and formulaic to assist staff in determining what they actually needed to do. Another example was that internal committees did not always have sufficient authority to make decisions.<sup>107</sup> At the hearing, the ATO reported that it is reviewing these arrangements.<sup>108</sup>
- 2.121 The final area was external connectedness, and the ATO provided evidence to the Committee that it had streamlined this, reducing 68 consultative forums to eight, with other groups being established on a special purpose basis.<sup>109</sup>
- 2.122 The Committee heard that the ATO had provided its first progress report to the APSC to implement the action plan, and that the progress report had been positively received. The Commissioner undertook to provide this and future quarterly progress reports to the Committee. To enhance accountability, the Committee would also appreciate being provided with a copy of the action plan.
- 2.123 After 18 months, the APSC is expected to conduct a further health check (follow-up review) of the ATO. At the hearing, the ATO said it expected that the health check would also be published.<sup>110</sup>

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105 Mr Geoff Leeper, *Transcript of Evidence*, p. 7.

106 Mr Geoff Leeper, *Transcript of Evidence*, p. 8.

107 Australian Public Service Commission, *Capability Review: Australian Taxation Office*, May 2013, p. 12.

108 Mr Geoff Leeper, *Transcript of Evidence*, p. 8.

109 Mr Geoff Leeper, *Transcript of Evidence*, p. 8.

110 Mr Geoff Leeper, *Transcript of Evidence*, p. 8.

## Level of external scrutiny

2.124 At the hearing, the ATO tabled a supplementary submission entitled External Governance Arrangements. It is reproduced in Appendix D. The ATO used the document as a way of showing that it was subject to considerable scrutiny:

It tries to put in pictorial form the various bodies that are our scrutineers and oversight and describe that. I thought it might be useful to have a picture – a fairly busy picture. There is enough going on. As an organisation we welcome oversight and input. I thought that might be useful.<sup>111</sup>

## Committee comment

### A contemporary ATO

- 2.125 The Committee supports the ATO's goal of becoming a contemporary service organisation that can quickly and seamlessly deal with most taxpayers with a minimum of fuss. To make an organisation contemporary requires transformation, which in turn requires vision. Strong and capable leadership pursues an organisation's vision and achieves the desired result.
- 2.126 Firstly focusing on vision, the recent APSC Capability Review appears to have been useful in assisting the ATO in realigning its focus into the mid and long-term. The Committee commends the Commissioner's desire to simplify and streamline the tax system to a 'light or no-touch' experience for most taxpayers.
- 2.127 Fostering willing participation by simplifying taxpayer interaction serves two goals at once. It increases compliance (hence raising revenue collection), and increases public support for the ATO.
- 2.128 In terms of leadership, the Committee acknowledges the significant changes at the ATO and the recent influx of staff from outside it. Decentralisation of the ATO's upper management can provide challenges, but also provides opportunities for better liaison with the community.
- 2.129 The Committee is optimistic about what can be achieved in simplifying taxpayer interaction through innovations such as pre-filing, and simplifying the e-tax process for those with uncomplicated affairs. The Committee is supportive of the ATO looking overseas to countries like

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111 Mr Chris Jordan AO, *Transcript of Evidence*, p. 20.

Norway and Denmark for examples of best practice, and looks forward to hearing of further innovations in this area.

- 2.130 The Committee will continue to monitor developments in this area, and will be focusing on these changes in a future hearing.

## Small business and individual taxpayers

- 2.131 The Committee is also pleased to hear that small business and individual taxpayers have benefited from recent improvements and the change of focus at the ATO. Tools such as online business viability assessment tools and industry benchmarking are extremely useful for small businesses, and the ATO should be commended for making these internal compliance checking tools available as a service to small businesses.
- 2.132 The Committee also notes the reduction in unpaid superannuation to employees due to a company entering insolvency, and expresses hope that success in collecting these debts for employees will continue to increase over the years.

## The tax gap

- 2.133 Given the time lag since 2012, the Committee would have preferred to have seen further progress on this issue at this stage. Nonetheless, the Committee is glad to see that there appears to be momentum in this area, and it looks forward to the ATO providing further information on this issue as the ATO's thinking develops.
- 2.134 The Committee notes the concern of the ATO that generating a tax gap estimate may lead to a focus from the public on the headline figure, rather than the confidence level around it. However, the Committee believes that developing a tax gap estimate and narrative can provide important information about the tax system for everyone. The Committee considers random audits to potentially be a core instrument in a raft of strategies that will combine to generate a key performance indicator for the ATO to accurately monitor the tax gap and address it over time.
- 2.135 The issues around random audits are also noted. However, the need for random audits, and the questions around valid sample sizes should not preclude the ATO from considering the range of methodologies for measuring the tax gap. The Committee also notes the contribution of the Inspector-General of Taxation that random audits can also test the effectiveness of the ATO's risk assessment tools more broadly.

## Staffing and service standards

- 2.136 The Committee notes the budgetary pressures facing the ATO over the last year, and notes the ATO's planned staff reductions.
- 2.137 The Committee notes several issues:
- Impact on revenue collection
  - The effect on the transformational program
  - Impact on service standards
  - The effect on regional offices.
- 2.138 The ATO's determination to prioritise the revenue collection function in the face of staff reductions should be commended. It should remain the priority of the ATO to collect the revenues due, within the absolute principle of fair treatment and respect to taxpayers.
- 2.139 The ATO stated that a reduced budget may slow down progress with its program of transformational change. The Committee notes that budget reductions can deliver savings in the short term, but in the case of the ATO, this needs to be balanced against retaining the capacity necessary to achieve larger long-run benefits. Realising substantial benefits in the future – not only in terms of more efficient administration but also a more streamlined system for all tax payers – may require continued investment in the short term.
- 2.140 The Committee understands that further staff cuts may lead to a reduction in service standards. This is not ideal. Where possible, and with budget permitting, the ATO should continue its quest for innovations and the use of information technology to achieve efficiencies to maintain, and in some cases improve on, service standards.
- 2.141 Examples of technological innovations are voice matching when calling into an ATO call centre, and greater automation of tax return processing through the reduction in paper lodgements. These can achieve the ATO's goals of improving taxpayer satisfaction and increasing compliance, as well as efficiencies in staffing levels. However, the Committee acknowledges that achieving these efficiencies takes time, is reliant on taxpayer take-up of these innovations, and may only lead to efficiencies in the mid to long term.
- 2.142 It was pleasing to hear that the ATO has no plan to leave any major regional centres, and that it aims to effectively manage its leased property in regional areas. The ATO maintains a flexible position on retaining a staffing presence in smaller regional centres where required. Measures like working from home or co-locating with other Commonwealth

agencies appear to be practical ways to retain a presence in a region without the overheads associated with leasing larger office spaces.

## Internal review of ATO decisions

- 2.143 The Committee was interested to hear about how the ATO was improving independence when it internally reviews its decisions. This has been a long-running concern of the Inspector-General of Taxation.
- 2.144 The Committee heard that the role of deciding objections had been moved out of Compliance Group and into the new Legal Services and Design Group. Separation at this level more closely resembles the recommendation of the Inspector-General of Taxation, and is a positive development in ATO administration.
- 2.145 The Committee also took evidence on the ATO's independent reviews, which occur during the audit process, before objections. These are currently limited to large business and international taxpayers for income tax and are soon to be expanded to GST for this group. The Commissioner advised the Committee that the reviews are designed to resolve these matters in an equitable and timely manner. The Committee was pleased to hear that the reviews had resolved several long running disputes.
- 2.146 The independent reviews can be regarded in different ways. For example, they could be seen as a method of quality assurance, where an internal expert with some independence reviews an internal ATO decision. Another perspective is that they are a type of alternative dispute resolution where someone partly separated from the case conducts an appraisal. Either way, early resolution assists both taxpayers and the ATO.
- 2.147 The previous review system in which, on occasion, a junior officer would review the decision of a more senior decision maker within the Compliance Group, does not stand up against better practice in due process. The new independent review system is hence a step in the right direction, as it creates more separation between the compliance area and the review team, as well as appointing a more senior reviewer to look over the case.
- 2.148 However, the Committee notes the concerns of the Inspector-General of Taxation that a case that has undergone an independent review before a formal objection has been made may result in the objection constituting a 'rubber stamp'. The Committee suggests that the ATO consider the Inspector-General's feedback and clarify how objections and independent reviews should fit together.
- 2.149 The Committee sees these reforms as part of the transformation of the ATO to a contemporary service organisation. A key focus for the

Committee will be to monitor the ATO's progress with them in future meetings.

## Scrutiny of the ATO

- 2.150 The ATO continues to receive positive feedback from its scrutineers. It is the Committee's observation that the ATO is well regarded by its scrutineers, and conducts itself in a professional and open manner.
- 2.151 The Australian National Audit Office, the Commonwealth Ombudsman, and the Inspector-General of Taxation stated that the ATO was willing to work positively with them, and to implement the great majority of their recommendations. This is to the credit of the ATO.
- 2.152 The Committee was pleased to hear the 'Second Chance Transfer' is an effective mechanism to improve ATO complaint handling, and that the total number of complaints about ATO administration has been trending down.
- 2.153 The ATO has been proactive in responding to the recent APSC Capability Review, and has embraced the recommendations made. An important phase of any review is to implement the recommendations. The ATO's Capability Review has three sets of documents that are relevant here:
- the action plan to implement the recommendations
  - quarterly progress reports on implementation
  - a health check review by the APSC to be conducted after 18 months to independently monitor outcomes.
- 2.154 The ATO made commitments to provide some of this documentation at the hearing and also expressed a general readiness to cooperate with the Committee on the review. The Committee would very much appreciate it if the ATO would be able to provide this documentation to the Committee, or arrange for it to be provided, so as to ensure that the ATO is accountable for responding to the review.
- 2.155 Finally, the Committee would like to recognise the valuable work of the scrutiny bodies to both the Parliament and the ATO.
- 2.156 At the hearing, the ATO commented that it is scrutinised extensively. The Committee would note, however, that much of this scrutiny is similar to other agencies. For example, almost all agencies are subject to the Auditor-General and the Ombudsman and appear before Senate Estimates. The fact that these agencies often focus more on the ATO reflects the importance of the ATO's role.
- 2.157 The main difference between most agencies and the ATO is that it has its own Inspector-General. In this respect, it is similar to the intelligence and

security agencies, and defence agencies, which also have an Inspector-General. Once again, this reflects their importance.

- 2.158 In its Capability Review, the APSC commented that the ATO is in the 'fortunate position' to receive a high level of scrutiny. The reasoning is that a high level of scrutiny is an effort to prevent serious, large scale lapses in its performance. The Committee accepts that current levels of scrutiny are appropriate and encourages the ATO to continue the professional way in which it engages with its scrutineers.

## The next hearing

- 2.159 In these hearings, the Committee has a range of roles. It scrutinises the ATO, and makes recommendations and follows-up on their implementation, but also appreciates it when the ATO improves service to taxpayers or achieves efficiencies. The Committee also has a role in highlighting problematic areas of tax administration and following them through with the ATO to assist in their resolution. These topics could be brought to the Committee's attention by the scrutineers or through other means.
- 2.160 The ATO has a major task ahead of it. Similar to the Auditor-General's observation, it is undergoing transformational change while at the same time facing a likely budget reduction.<sup>112</sup> The Committee believes that the ATO can, and indeed must, become a contemporary, streamlined service organisation that handles the majority of taxpayers' affairs seamlessly.
- 2.161 The Committee also believes that this can, and must, be done while maintaining revenue collection and ensuring that service standards remain high.
- 2.162 The ATO has refreshed its leadership team and has a range of tools, such as the Capability Review, to achieve these goals. However, the Committee is conscious of the challenges and trade-offs necessary to transform an organisation with reduced budgets. The Committee is aware of and sensitive to the likely budget position, and the Committee is considerate of the timing of budget changes, so as not to impede the progress of transformation that will deliver long term benefits. The Committee will monitor both the ATOs and the Government's approach to this challenge in future hearings.

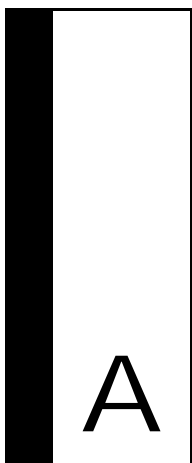
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112 Auditor-General, *Submission No. 3*, p. 2.

- 2.163 The Committee plans to next meet with the ATO and its scrutineers on Wednesday, 27 August 2014, and requests that the submission provide information on progress in the following areas:
- Measuring the tax gap
  - Proposals to improve public reporting of performance information and how performance information is integrated into ATO management decisions
  - How the ATO benchmarks its performance against other agencies, in Australia and overseas, and provide such data to the Committee. This should include, but not be limited to, data comparing staffing levels with the amount of revenue collected in Australia and other jurisdictions, including the UK, New Zealand, and the Republic of Ireland, and if possible, Denmark and Norway.
  - Internal review of ATO decisions, to include progress in making independent reviews more widely available
  - An update on reinventing the ATO, including the progress reports from the APSC Capability Review and the action plan
  - An update on consultations regarding section 25.90 of the *Income Tax Assessment Act 1997*
  - Impacts of budget and staffing reductions, including their effect on revenue and service standards.
- 2.164 Further, the Committee requests that the ATO's submission containing this, and other relevant information, be lodged no later than Friday, 8 August 2014.

John Alexander OAM, MP  
Chair  
26 March 2014





## Appendix A – Submissions

1. Commonwealth Ombudsman
2. Inspector-General of Taxation
3. Australian National Audit Office
4. Australian Taxation Office
  - 4.1 Supplementary Submission





## Appendix B – Public hearings

**Canberra, 28 February 2014**

### **Australian Taxation Office**

Mr Chris Jordan, Commissioner of Taxation

Mr Geoff Leeper, Second Commissioner, People Systems and Services Group

Mr Neil Olesen, Second Commissioner, Compliance Group

Ms Alison Lendon, Acting Second Commissioner, Law Design and Practice Group

### **Australian National Audit Office**

Mr Ian McPhee, Auditor-General

Mrs Barbara Cass, Group Executive Director, Performance Audit Service Group

Mr Andrew Morris, Executive Director, Performance Audit Service Group

Mr Phillip Sands, Executive Director Assurance, Audit Service Group

Mr Michael White, Executive Director, Assurance Audit Service Group

### **Office of the Commonwealth Ombudsman**

Mr Colin Neave, Commonwealth Ombudsman

Mr Richard Glenn, Deputy Ombudsman

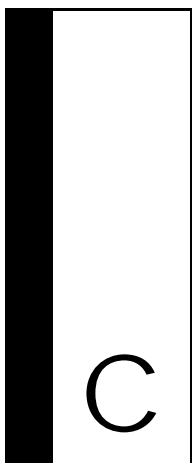
Mr Rodney Lee Walsh, Senior Assistant Ombudsman

### **Office of Inspector-General of Taxation**

Mr Ali Noroozi, Inspector-General of Taxation

Mr Andrew McLoughlin, Deputy Inspector-General of Taxation

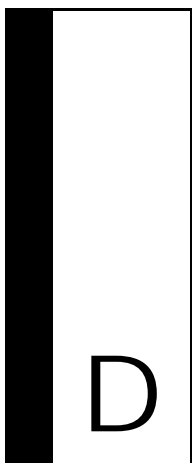




## Appendix C – Exhibits

1. Inspector-General of Taxation, *Work program public consultation: A brief for the Joint Committee of Public Accounts and Audit*, December 2012 (provided by the Inspector-General of Taxation)





## Appendix D – ATO Submission 4.1

The submission is reproduced overleaf.

# External Governance arrangements

