

Public Hearing with the Standing Committee on Tax and Revenue

Friday, 28 February 2014

Opening Statement

Mr Ian McPhee PSM, Auditor-General

Thank you for the invitation to appear at this hearing this morning. I will briefly comment on the Australian National Audit Office's audit coverage of the Australian Taxation Office (ATO) and make some observations in relation to the ATO's administration, reflecting our recent audit activity.

Our audit coverage of the ATO is directed towards giving Parliament independent assurance in relation to the ATO's annual financial statements; and to help improve the efficiency and effectiveness of the ATO's administration by undertaking independent performance audits for the information of Parliament and the Executive. Apart from our audit opinion on the fair presentation of the ATO's financial statements, we produce around five performance audits specifically related to the ATO each year and we also assess aspects of the ATO's administration through cross-agency performance audits. The ATO provides the access and assistance necessary for us to conduct our audits, and the working relationship between the ANAO and ATO is a positive one.

Over the course of previous hearings with the Commissioner of Taxation conducted by the Joint Committee of Public Accounts and Audit (JCPAA), I have observed that the ATO has been well served by sound governance structures and approaches for managing risks across a large and diverse organisation. Nevertheless, challenges for the ATO remain as it continues

to administer complex legislation in a way that collects the revenue due while ensuring that taxpayers' rights are respected and upheld. Its administration must also adjust to a tighter budgetary position as well as implement a program of substantial reform to governance, risk management and service delivery arrangements initiated by the ATO senior executive.

The ATO's financial statements for 2012–13 were of a standard that allowed us to provide an unqualified audit opinion. The ATO has designed and implemented governance arrangements, a financial reporting regime and an internal control system to provide reasonable assurance about the ATO's business operations. These arrangements are designed to support the ATO's financial reporting requirements, the effectiveness and efficiency of its operations and compliance with applicable legislative requirements. The ATO has made a concerted effort to address audit findings raised by the ANAO. The number of significant and moderate risk audit findings has steadily declined from 18 issues in June 2004 to the point where there were no outstanding legislative matters and no significant audit findings in June 2013. From a financial perspective, the ATO operated within its overall departmental budget in 2012–13, and will need to continue to actively manage its budgetary position to achieve this result in 2013–14, due to the impact of efficiency and other dividends on its operations.

Since the previous JCPAA hearing with the Commissioner of Taxation in late June 2013, we have completed two performance audits relating to the ATO's: administration of the taxation of personal services income tax; and management of complaints and other feedback. As indicated in the attached summaries, these audits highlighted opportunities for further improvements through:

- strengthening the assessment of personal services income compliance risk to obtain a better understanding of the extent to which wage and salary earners may be incorrectly accessing the business tax system; and
- proactively addressing issues that can give rise to complaints, particularly when major business and process changes are being implemented and when there is an intensive period of processing income tax returns such as the annual tax time.

There are also three performance audits currently underway that are reviewing aspects of the ATO's administration: managing the compliance of highly wealthy individuals; the implementation of the Compliance Effectiveness Methodology; and the administration of the Australian Business Register. The ATO is also included in a cross agency audit examining how agencies protect themselves against cyber attacks and secure their information technology systems.

A particular focus of our recent engagement with the ATO has been to reflect JCPAA and parliamentary interest in the standard of reporting against the Australian Government Performance Measurement and Reporting Framework. Against the background of the new powers under the *Auditor-General Act 1997* to audit key performance indicators (KPIs), a pilot project in 2011–12 examined a selection KPIs of three volunteer agencies, including the ATO, as a basis for implementing a future program of audits of entities' KPIs, and to develop a suitable audit methodology. The pilot found that all entities continued to experience challenges in developing and implementing meaningful performance indicators. The ATO also participated in the subsequent 2012–13 pilot project (due to be tabled within the next two months).

Chair, we have found the ATO is responsive to the issues we raise and has a positive attitude to adopting improvements which will strengthen its administration of its very significant responsibilities.

Thank you.

**Administration of the Taxation of Personal Services Income
(No.5 of 2013–14)**

Background: The personal services income (PSI) regime is one of many taxation measures administered by the Australian Taxation Office (ATO). PSI is defined by Part 2–42 of the *Income Tax Assessment Act 1997* as income gained mainly as a reward for the personal efforts or skills of an individual. PSI rules were introduced on 1 July 2000 to address the erosion of the tax base arising from taxpayers alienating PSI—that is, gaining taxation advantages such as claiming business deductions and splitting income earned from personal services when they were not genuinely conducting a business. The PSI rules are intended to tax income earned from personal services in a broadly similar way to the income of people who are employees, and to not impact on genuine business undertakings. The legislation introduced five tests to enable entities to self-assess whether the PSI rules apply to them before submitting their tax return.

In 2001, the revenue estimate for the regime was revised, calculating that the PSI regime would raise \$2.3 billion over the first six years of operation, mainly by reversing the trend of wage and salary earners accessing the business tax system to gain tax advantages. In 2010–11, the latest data the ATO could provide at the time of preparation of the report, around 426 000 taxpayers declared the receipt of PSI income and, of these, 302 000 were assessed as personal services businesses and therefore exempt from the PSI rules. The remaining 124 000 entities, for whom the PSI rules applied, reported \$2.9 billion in net PSI.

Audit Objective: to assess the effectiveness of the Australian Taxation Office's administration of the personal services income regime.

Summary of Conclusion: The ATO had effectively administered many of the key elements of the regime, including developing sound governance arrangements and appropriate business planning, risk management and reporting processes; and an evolving program of compliance activities to promote voluntary compliance and to address non-compliance with PSI obligations. The ATO last attempted to quantify the net revenue impact of the PSI rules and the population of taxpayers that do not declare PSI in 2004–05, but was unable to do so with any reliability or accuracy; and there had been no subsequent attempts. The ATO had also yet to determine whether its compliance activities were effectively mitigating the ongoing alienation of PSI risk. Nevertheless, the ATO advised that it was endeavouring to better understand and estimate the population of non-compliant taxpayers as part of the PSI compliance effectiveness assessment underway and anticipated to be completed in late 2013. A methodology to estimate the magnitude of the potential revenue at risk from this non-compliance would contribute to establishing a baseline for comparison over time in future compliance effectiveness assessments.

Key Findings:

- PSI is considered by the ATO to be an 'endemic risk', as it continues to be identified through compliance and data matching activities. Comprehensive PSI risk assessments were conducted in 2008 and 2011, and show very little change in the risk profile. In particular, the percentage of taxpayers that reported earning most of their taxable income from personal services, as opposed to earning other forms of income as well as PSI, was around 30 per cent (26 400 taxpayers) in 2005–06 and 29 per cent (30 000 taxpayers) in 2009–10.
- It would be beneficial to estimate the size of the non-compliant PSI population, in light of findings from a 2012–13 PSI risk assessment exercise. This 'risk summary' identified that ATO data matching exercises had found that 81.5 per cent of entities in the selected

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Group Executive Director: Barbara Cass

Executive Director: Andrew Morris

sample may have incorrectly classified their income by not declaring their personal services business status.

- The ATO has found that at risk PSI taxpayers have common links with other non-compliant contractors it manages.¹ As a consequence, compliance activities being undertaken by other areas of the ATO will include PSI taxpayers. The ATO acknowledges that currently, these interactions across the ATO are not well communicated or appropriately documented. Capturing this information and analysing the outcomes of these compliance activities would assist with the ongoing assessment and reporting of the range of risks associated with the contractor population.
- Stakeholders interviewed by the ANAO held mixed views about the complexity of the PSI regime.² Some considered the rules complex and difficult to comply with, while others thought the regime was now operating more smoothly. The ATO has acknowledged that further communication is required to raise awareness and to improve taxpayers' and tax practitioners' understanding of their PSI obligations.
- The ATO has a range of strategies for addressing non-compliance with the PSI regime. Letter campaigns are increasingly being used as a less resource-intensive method for interacting with a larger number of the potential PSI population, with over 10 700 letters being sent between January 2012 and June 2013. Although the number of compliance reviews and audits has declined significantly (from over 800 cases in 2003–04 to 441 cases finalised in 2012–13), additional revenue collected has been relatively steady and the average revenue per case has increased over time. The ATO has calculated that compliance enforcement activities (including letter campaigns), which are based on an annual review of the alienation of PSI risk, have resulted in \$38 million in additional revenue being collected over the last 10 years.
- Work is being undertaken to measure the effectiveness of compliance activities in addressing the alienation of PSI risk, using the ATO's Compliance Effectiveness Methodology, although at the time of this audit the assessment had not been completed. The ATO has not attempted to quantify the level of non-compliance in the PSI population since 2004–05, or developed a methodology to assess the magnitude of the related revenue at risk. These estimates are an important element in any assessment of the effectiveness of PSI compliance activities and would establish a baseline for comparison with future PSI risk and compliance effectiveness assessments.

Recommendation: The ANAO made one recommendation aimed at strengthening the assessment of the PSI compliance risk and the effectiveness of PSI compliance activities, by estimating the population of non-compliant taxpayers and the magnitude of revenue at risk.

Summary of agency response: The ATO agrees with the report's recommendation.

Refer to attachment for details of recommendations and agency responses to these recommendations.

¹ Other contractor risks being managed by the ATO include: 'sham contractors', who receive income that should be classified as salary and wages; 'non-lodgers', taxpayers (including contractors) who receive income but fail to register or to submit tax returns; and 'level playing field', the project addressing contractors who understate or omit income from their tax returns.

² Stakeholders interviewed included CPA Australia; the Association of Professional Engineers, Scientists and Managers Australia; the Civil Contractors Federation; the Housing Industry Association; Independent Contractors Australia; Master Builders Australia; and Taxpayers Australia.

Administration of the Taxation of Personal Services Income (No.5 of 2013–14)

Recommendation and agency responses

Recommendation No.1 (Para 5.36)

To better inform its assessment of the alienation of personal services income (PSI) risk and the effectiveness of PSI compliance activities, the ANAO recommends that the Australian Taxation Office:

- (a) estimates the number of non-compliant PSI taxpayers; and
- (b) develops a methodology to assess the magnitude of the potential revenue at risk from this non-compliance.

Australian Taxation Office response – Agreed.

Summary of ATO's response

The ATO welcomes this performance audit and considers the report supportive of our overall approach to administering the personal services income (PSI) regime. The audit recognises that the ATO has effectively administered key elements of the PSI regime including the development of sound governance arrangements, appropriate business planning, risk management and reporting processes.

The ATO agrees with the report's recommendation that the assessment of the alienation of PSI risk and the effectiveness of PSI compliance activities can be further informed by estimating the number of non-compliant PSI taxpayers, and developing a methodology to assess the potential magnitude of the revenue at risk from the estimated non-compliance.

**Management of Complaints and Other Feedback
(No.19 of 2013–14)**

Background: The Taxpayers' Charter sets out the way the Australian Taxation Office (ATO) will conduct itself when dealing with taxpayers and underpins the ATO's complaints management approach. The ATO has committed, in the Taxpayers' Charter, to respect the right of taxpayers to complain if they are dissatisfied with an ATO decision, service or action.

The ATO receives complaints, compliments and other feedback from taxpayers or their representatives through a range of avenues, including: over the telephone; online through complaints and feedback forms, including the tax agent portal; and by correspondence and facsimile. Complaints and other feedback may also come through the Commonwealth and Taxation Ombudsman (Ombudsman) and taxpayers can write to the Treasurer or Assistant Treasurer, including through their local Member of Parliament, where they have a complaint. A centralised team (ATO Complaints) oversees complaints management, while the resolution of complaints is devolved to business and service lines.

The ATO has processed around 36 000 complaints, on average, annually for the past five years. It experienced a significant increase in the number of complaints received between 2009–10 and 2011–12. A major cause of the large increase in the number of complaints received in 2009–10 was the introduction of the income tax component of the ATO's information technology Easier Cheaper More Personalised Change Program. This increase in the number of complaints continued in 2010–11, before declining in 2011–12 and 2012–13. In 2012–13, of complaints finalised, 16 135 (or around 63 per cent) were upheld.

Audit Objective: To assess the effectiveness of the ATO's complaints and other feedback management systems in supporting service delivery.

Summary of Conclusion: The ATO's complaints handling framework is well-designed and its management arrangements are generally sound. The ATO has strengthened complaints handling in recent years, and there has been a rebound in client satisfaction and community perceptions in the 2013 corporate surveys. Nevertheless, opportunities remain to more fully address the principles of fairness, accessibility, responsiveness, integration and efficiency outlined in the Commonwealth Ombudsman's *Better Practice Guide to Complaint Handling*.

In addition, while there have been instances where the ATO has used complaints intelligence to address systemic issues that give rise to complaints, there is scope for it to better use intelligence from client feedback to more actively inform service delivery and improve efficiency. This includes developing strategies to minimise complaints occurring in the first place and better managing taxpayer's expectations by keeping them informed throughout their dealings with the ATO.

Key Findings:

- The ATO has a sound framework for handling complaints and other feedback that includes: a centralised area to oversee the management of complaints and other feedback (ATO Complaints); detailed policies and instructions on the handling of complaints and other feedback; separate areas within ATO business and service lines to respond to complaints in their areas; the use of the client relationship management system to collect information about complaints and other feedback; quality assurance arrangements; and regular reporting of complaints handling performance.

- The ATO aims to finalise complaints within 21 calendar days (15 business days from July 2013). This measure has included complaints completed within 21 calendar days or within any extended timeframe placed on the complaint case. It would increase transparency and accuracy of reporting against this measure if the ATO were to report on the percentage of complaints finalised within the revised 15 business day target without adjusting for complaints that are finalised outside this period; and separately on those finalised within an extended finalisation date that has been arranged with complainants.
- While the ATO carries out a number of quality assurance activities on complaints handling, these activities are fragmented. Having a more systematic agency-wide approach to the quality assurance of complaints handling would provide the ATO with information that could be used to further improve the processing of complaints.
- In relation to the confidentiality of complaints information, the ANAO identified a privacy risk regarding the handling of named officer complaints. Notwithstanding advice that the ATO's policy is to minimise the incidence of naming the ATO officer in complaints records, including attachments, there were 12 instances out of 20 named officer complaints sampled by the ANAO where the officer's name, and details of the investigations, were included in linked activities on complaints records. Including such details means that any ATO officer who accesses a taxpayer's records would be able to examine details of any complaints made about ATO officers and details of the investigations
- In terms of efficiency, currently the ATO does not have information on the cost of managing complaints. Based on data provided by business and service lines, the ANAO estimates that the average total unit staff cost per complaint was \$611 in 2012–13 and \$382 per complaint when staff support costs such as analysis, coordination, reporting and quality assurance are not included.
- There have been a number of instances where the ATO has analysed complaints information to address systemic issues that give rise to complaints. This has included using lessons learnt from complaints received in 2011 tax time (July to October) about the implementation of the Income Tax Return Integrity program to improve the way in which this program was subsequently implemented. Nonetheless, there is scope for the ATO to undertake further analysis and develop strategies to minimise complaints occurring (for example, by better explaining and publicising tax time changes and any major systems and process changes, to better manage taxpayer expectations).

Recommendations: The ANAO has made three recommendations aimed at:

- improving reporting against complaints handling timeliness measures, and developing other performance measures;
- implementing a more coherent agency-wide quality assurance framework for complaints and other feedback; and
- limiting sensitive information about named officer complaints from being included in records on the ATO's client relationship management computer system, and implementing measures to check that ATO officers have not accessed these records inappropriately.

Summary of agency responses

The Australian Taxation Office agreed with the three recommendations in the report. The attachment provides details of these recommendations and agency responses.

JCPAA Briefing - Attachment



Management of Complaints and Other Feedback (No.19 of 2013–14)

Recommendations and agency responses

Recommendation No.1 (Para. 2.33)

To improve transparency, the ANAO recommends that, in reporting performance against its published timeliness resolution target, the ATO reports on the percentage of complaints that were finalised within:

- (a) the target timeframe (from 2013–14, 15 business days) without adjusting for extended timeframes that may be arranged with complainant;
- (b) any extended timeframes arranged with complainants separately.

Australian Taxation Office response: Agreed.

Recommendation No.2 (Para. 2.46)

To better monitor the quality of complaints handling, the ANAO recommends that the ATO:

- (a) implements an agency-wide quality assurance framework for complaints and other feedback that provides results at an agency-wide and individual business and service line level; and
- (b) includes these results in monthly complaints and community feedback reports.

Australian Taxation Office response: Agreed.

Recommendation No.3 (Para. 4.26)

To better address the privacy risks associated with named officer complaints, the ANAO recommends that the ATO:

- (a) restricts information detailing the nature of the complaint and its investigation from being included in the complainant's record on the client relationship management system; and
- (b) investigates implementing measures to periodically check that named officers have not accessed related complaints records.

Australian Taxation Office response: Agreed.