



**Australian Government**  
**Inspector-General of Taxation**

# Tax Forum — next steps for Australia

**A submission to the Tax Forum**

**Inspector-General of Taxation**

September 2011



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**SEPTEMBER 2011**



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## 1. EXECUTIVE SUMMARY

The Inspector-General of Taxation (IGT) welcomes the opportunity to participate in the Tax Forum and is pleased to provide this submission to generate debate on one of the designated topics: namely, Tax System Governance.

Governance is a key aspect of any tax system. The approach of tax administrators has a direct bearing on policy implementation and taxpayer confidence through application of fairness, certainty, transparency, minimisation of compliance costs and reduction in unnecessary complexity. Accordingly, the development of a more effective and comprehensive set of governance arrangements for the Australian Taxation Office (ATO) has strong merit.

This submission outlines three key options for consideration. These are:

1. Establishment of a management board (such as those of an advisory or supervisory nature) to bring into the ATO a diverse mix of expertise and experience including information technology, human resources, finance and communication.
2. Appointment of additional Second Commissioners from the private sector to diversify the ATO Executive Committee, inject a wider range of experiences and perspectives and also provide intelligence on trends in corporate governance and taxation risks. These additional Second Commissioners to be appointed to lead the more contentious areas of the ATO, including one as head of a separate appeals area.
3. Enhancement and centralisation of the ATO scrutineer function to provide a single port-of-call for taxpayer grievances with tax administration, be they specific disputes or systemic issues. A more co-ordinated approach to ATO scrutiny would also minimise duplication and the cost of external scrutiny.

The three options form an integrated package that provides synergistic benefits beyond each as stand-alone considerations. The package supports a more comprehensive governance framework aimed at providing the ATO with a wider range of expertise to deal with present and future challenges, as well as improving taxpayer experience.

The management board has strong stakeholder support and the Government is currently considering its implementation. The IGT recommends that options 2 and 3 be also considered by the Tax Forum to further address the systemic issues identified by business and tax professionals.

## **2. INTRODUCTION**

The Tax Forum convened by the Australian Government provides a unique opportunity for the Australian community to contribute to the future direction of Australia's tax and transfer system. The IGT welcomes the opportunity to provide this submission and participate at the Forum.

The IGT is well-positioned to explore and contribute to a number of matters regarding tax administration given his office's function, expertise and broad-based consultative relationship with both government agencies and private-sector stakeholders at all levels in the community.

In seeking to address the designated topics for the Forum, this submission focuses on specific matters affecting governance of the ATO. The submission takes a three pronged approach by addressing the need for a management board (such as those of an advisory or supervisory nature), diversification in the ATO Executive Committee and an improved ATO scrutineering function.

There are a range of other important tax administration system issues that the IGT is also considering, but these may be addressed in the conduct of the IGT's core work program.

This submission draws upon earlier IGT submissions to the Australia's Future Tax System (AFTS) review dated 3<sup>rd</sup> and 30<sup>th</sup> of September 2009 respectively.

## **3. CURRENT ATO GOVERNANCE ARRANGEMENTS**

### **3.1 EXTERNAL GOVERNANCE**

The external governance arrangements currently overseeing the ATO are considerable, many of which have evolved in a piecemeal fashion over the last thirty years.

The Commonwealth Ombudsman, established in 1977 as part of the federal government's coordinated approach to administrative law reform development, is, in the main, responsible for investigating taxpayer complaints. In addition, the Australian National Audit Office (ANAO) carries out performance and financial statement audits.

Following the Ralph Review in 1999, the Board of Taxation was established to provide a business and community perspective on the tax system, including advice on improvements that can be made to the implementation of tax laws.

The IGT, established in 2003, reviews systemic tax administration issues and reports to the Government with recommendations for improvement for the benefit of all taxpayers.



The ATO also has formal accountability to ministers and Parliament through its annual reporting and appearance before parliamentary bodies such as the Joint Committee of Public Accounts and Audit (JCPAA) and the Senate Economics Legislation Committee. Since 2007, the JCPAA has held a biannual public hearing with the Commissioner of Taxation in the interests of greater public accountability and transparency. More recently the JCPAA has foreshadowed greater scrutiny of the ATO through the biannual public hearings having given notice to the Commissioner that he will be required to address issues or concerns raised by scrutineer agencies such as the IGT, the Ombudsman and the ANAO.

## **3.2 INTERNAL GOVERNANCE**

The Commissioner of Taxation has established the ATO Executive Committee to assist him in setting the longer term direction of the ATO and to administer aspects of Australia's tax and superannuation systems, while delivering the ATO's commitments to government.

The ATO Executive Committee currently comprises eight senior tax officers including the Commissioner (as Chair), the Second Commissioners and other senior ATO officers (as nominated from time to time by the Chair). Currently, the additional senior ATO members are the Chief Finance Officer, the First Assistant Commissioner ATO People, the Chief Information Officer and the Chief Operating Officer. Independent advisers and other senior ATO representatives may be required to attend and present a report relating to their area of responsibility as a standing item.

## **4. CASE FOR REFORM**

The issues relating to ATO governance and the need to reform are not new and date back to the 1975 Asprey Review. The IGT believes that there is merit in the Tax Forum considering the adequacy of these arrangements given:

- international trends establishing comprehensive governance frameworks, including the creation of management boards and specific governance functions;
- strong community support for ATO governance reforms to ease the burden of compliance on taxpayers including reducing compliance costs; and
- underlying concerns regarding ATO capabilities and approaches evidenced in IGT reviews and community consultations.

## 4.1 INTERNATIONAL TRENDS AND PERSPECTIVE

Management boards are now a characteristic of many revenue authorities around the world, including the United States and United Kingdom.<sup>1</sup> It is important that Australia keeps pace with international changes in tax administration and adopts those features that would likely deliver benefits in the Australian context. A 2006 International Monetary Fund (IMF) Working Paper<sup>2</sup> also notes that management boards have now become a common feature of a comprehensive governance framework.

### 4.1.1 United States Tax Administration Governance

The Internal Revenue Service (IRS) Oversight Board (the IRS Board) was created by the IRS Restructuring and Reform Act of 1998 (USA). The IRS Board has seven Presidential appointees together with the Secretary of Treasury and the IRS Commissioner. The aims of the IRS Board are to improve accountability, continuity, expertise and to provide a private sector perspective.

#### 4.1.1.1 Role and responsibilities of the IRS Board

The IRS Board operates much like a corporate board of directors, but is tailored to fit a public sector organisation. The IRS Board provides the IRS with long term guidance and direction, and applies its private sector experience and expertise in evaluating the IRS progress in improving its service. Specifically, the responsibilities of the IRS Board are to:

- review and approve the IRS budget;
- review and approve the IRS strategic plan;
- select and evaluate some senior IRS executives; and
- submit the annual report to Congress.

The IRS Board meets five or more times a year and has a number of committees that assist in its functions and responsibilities – they include an operations committee (which oversees the service and enforcement functions of the IRS), an operations support committee (which oversees the human capital, training, information technology and support functions at the IRS) and the executive committee (which oversees agency-wide personnel matters at the IRS). These committees also meet quarterly to review the array of performance measures against targets. The IRS Board is also active in ensuring that it remains informed – for instance, it holds IRS briefings, it attends Congressional Committees, it makes a number of field visits to both IRS and stakeholder sites and maintains a Stakeholder Outreach Program, which includes conducting annual public

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1 Organisation for Economic Co-Operation and Development, *Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series (2010)*, 3 March 2011, pp. 31-36.

2 Kidd, M. and Crandall, C., *Revenue Authorities: Issues and Problems in Evaluating Their Success*; IMF Working Paper 06/240; 1 October 2006.

meetings, attending nationwide tax forums, conducting an annual taxpayer satisfaction survey and maintaining an ongoing relationship with tax professionals.

Under the law, the IRS Board cannot be involved in specific law enforcement activities, including audits, collection activities or criminal investigations. It also cannot be involved in specific procurement activities and it does not develop or formulate tax policy or practice in relation to existing or proposed tax laws.

The IRS notes that there are a number of major trends affecting tax administration including the increasing complexity of tax administration, growing human capital challenges, an increase in electronic data, online transactions and related security risks and accelerating globalisation. The IRS believes that the existence of a management board allows it to adapt to these changing circumstances by injecting a wider range of experience, expertise and approaches to tax administration.

#### **4.1.1.2 Role and responsibilities of the Taxpayer Advocate Service**

In addition to the IRS Board, the Taxpayer Advocate Service (TAS) was also established to help taxpayers resolve problems and recommend changes. The TAS is an independent organisation within the IRS whose employees assist taxpayers who are experiencing economic harm, who are seeking help in resolving tax problems that have not been resolved through normal channels or who believe that an IRS system or procedure is not working as it should. The functions of the TAS are set out in the Taxpayer Bill of Rights as follows:

- to assist taxpayers in resolving problems with the IRS;
- to identify areas in which taxpayers have problems in dealing with the IRS;
- to propose changes in the administrative practices of the IRS to mitigate those identified problems, to the extent possible; and
- to identify potential legislative changes that may be appropriate to mitigate such problems.

The TAS is headed by the National Taxpayer Advocate, who is appointed by the head of the Treasury and reports directly to the Commissioner of Internal Revenue.

Taxpayers may be eligible for assistance if:

- they are experiencing economic harm or significant cost (including fees for professional representation),
- they have experienced a delay of more than 30 days to resolve their tax issue, or
- they have not received a response or resolution to the problem by the date that was promised by the IRS.

The Office of Systemic Advocacy is part of the larger TAS organisation. Systemic advocacy means addressing broad issues that impact groups of taxpayers, including both individuals and businesses. These issues normally:

- affect multiple taxpayers;
- affect segments of the taxpayer population, locally, regionally or nationally;
- relate to IRS systems, policies, and procedures;
- require study, analysis, administrative changes or legislative remedies; and
- involve protecting taxpayer rights, reducing or preventing taxpayer burden or ensuring the equitable treatment of taxpayers.

The Office of Systemic Advocacy works within the IRS to resolve issues involving procedures and policies by bringing those issues to the attention of IRS management and by making legislative proposals in the annual report to Congress where necessary.

The TAS provides two annual reports to Congress – one which identifies the priority issues the Office of the Taxpayer Advocate will address in the coming fiscal year and the other which includes a summary of the most serious problems encountered by taxpayers, recommendations for solving those problems and other IRS efforts to improve customer service and reduce taxpayer burden.

#### **4.1.2 United Kingdom Tax Administration Governance**

The United Kingdom's HM Revenue and Customs (HMRC) is a non-ministerial department similar to that of the ATO. This makes it different from most other government departments which work under the direct day-to-day control of a minister.

Legislation for the creation of the new HMRC department was enacted in 2005 and included provision for the creation of a management board comprising a Non-Executive Chairman, five internal HMRC Executive Committee members and four external Non-Executive Directors (the HMRC Board).

##### **4.1.2.1 Role and responsibilities of the HMRC Board**

The Chairman leads the HMRC Board which sits a minimum of ten times a year and has the following responsibilities:

- development and final approval of HMRC's overall strategy;
- development and final approval of HMRC's communications strategy and sign off for significant communications identified within it;
- development and final approval of the culture and values objectives and strategies;
- approval of the final sub-strategies of business lines and functions;

- approval of final business plans (including the annual financial plan);
- advising the Chief Executive on the appointment of senior executives; and
- ensuring the strength of the HMRC Board and committees by participating in the appointment of and advising on the ongoing competence of board members, Executive Committee members and other key appointments.

The HMRC Board's Non-Executive Directors are senior business figures from outside the department who bring a diverse mix of expertise and skills from across both the public and private sector. HMRC looks to its Non-Executive Directors to:

- bring guidance and advice;
- support and challenge management about the department's strategic direction; and
- provide support in monitoring and reviewing progress.

In approving the strategies and plans, the HMRC Board must ensure that the views of HMRC's stakeholders are taken into account.

The HMRC Board is supported by the People, Ethics & Responsibilities and Audit & Risk committees to assure the highest standards of corporate governance are in place. Membership of these committees is drawn exclusively from the Non-Executive Directors, with each committee having its own terms of reference setting out its membership, responsibilities, reporting and information requirements.

In addition to the HMRC Board, the Chief Executive Officer is responsible for providing leadership and direction to the department and runs all aspects of HMRC's business, ensuring delivery of the strategic objectives and driving continuous improvement.

The Permanent Secretary for Tax reports to the Chief Executive as the Deputy Chief Executive and is the senior tax professional in HMRC. The Permanent Secretary has specific well-defined accountabilities in the areas of tax policy and tax strategy.

The Chief Executive Officer and the Permanent Secretary, together with the other Commissioners, make up the Executive Committee, which is the executive decision making body for HMRC. Following the strategic direction provided by the HMRC Board, the Executive Committee oversees the whole breadth of HMRC's work and is responsible for driving forward continuous improvement and change agendas. It initiates and supervises at a high level the practical steps required to deliver the department's vision.

The Executive Committee's responsibilities include:

- ensuring effective and efficient delivery of the department's business;
- shaping departmental behaviours, policies, processes and structures to achieve our objectives;

- leading and promoting change to secure improved performance – including successful delivery of the portfolio of major programmes and projects;
- reviewing overall business planning and performance and its contribution to the delivery of departmental objectives and targets;
- oversight of the development and management of business lines and function strategies;
- ownership and management of key strategic risks;
- managing external relations with stakeholders and promoting the department's good reputation; and
- providing oversight of HMRC's governance arrangements to ensure they remain robust and appropriate.

### **4.1.3 International Monetary Fund Working Paper**

An IMF Working Paper<sup>3</sup> found that 75 per cent of surveyed revenue authorities had boards, and nearly all were empowered management boards with specific responsibilities and oversight functions. While the IMF paper was not unequivocal on the real influence of management boards in improving tax administration, it did note management boards with private sector representation may be able to inject a more business-orientated approach to the workings of a revenue authority and thus bring more rigour to financial and human resource matters.

The IMF paper also lists a number of considerations concerning the design of a comprehensive governance framework, including the roles and responsibilities of the government, the board and the Chief Executive Officer, so as to ensure that revenue authorities discharge their functions and remain accountable as a public institution. Excerpts of the relevant sections of the IMF Working Paper are contained in Appendix 1.

## **4.2 COMMUNITY CALLS FOR ATO GOVERNANCE REFORMS**

In submission to the AFTS review, a number of stakeholders (for example, the Group of 100 (G100), Corporate Tax Association, Australian Bankers Association (ABA) and the Business Coalition for Tax Reform) suggested the need to improve the pre-existing governance models through the introduction of a management board. In support of such a proposal, the G100 submission pointed to increasing complexity in response to economic and social trends and the need to keep pace with global business developments. Likewise, the ABA submission pointed to various examples of ATO approaches where it considers that problems are getting more difficult, not better, and, in the ABA's view, indicates that

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<sup>3</sup> Ibid; Note also, reference to this paper in Crandall, C., *Revenue Administration: Autonomy in Tax Administration and the Revenue Authority Model*, IMF Technical Notes and Manuals, 18 June 2010.

there are systemic issues involved in achieving consistency and balance in tax administration.

The G100 submission suggested that a complex system without someone capable of administering that system objectively, consistently and in a timely manner will fail irrespective of improvements to the policy settings. It noted that the ATO has over the years been given a number of duties apart from responsibility for the collection of tax including administering social welfare programs, superannuation and pension programs, the administration of certain aspects of charitable institutions and other support services to various government agencies. The G100 stated that this increase in scope of ATO activities places additional stresses and strains on its resourcing, human capital needs, managerial capability, governance and risk management framework.

The G100 submitted that the operation of market forces means that the majority of the ATO staff, including those in senior ranks and managerial positions, have little or no experience in the private sector and that their entire cultural upbringing and corporate mindset has been fashioned by a public sector outlook and upbringing. The G100 believed that, because of the different culture sets between the private sector and the human capital upbringing within the ATO, there is a 'disconnect' which results in a sense of distrust and lack of empathy. The G100 considered that this disconnect can only be systematically addressed by introducing oversight, including external guidance as part of an overall risk management and governance framework, so as to lead to an improvement in ATO culture and performance.

Similarly, the ABA and the Business Coalition for Tax Reform recommended the need for a broader cultural change in tax administration so as to have more regard to underlying policy and greater recognition of business realities. The ABA submitted that such a cultural change requires internal processes within the ATO, not more external reviews. In support of a board, the ABA referred to the establishment of the Board of Taxation in relation to tax policy as a significant success and submitted that it should be considered as a model for the ATO.

The G100 also expressed particular concern that the perceived culture within the ATO demonstrated a bias to revenue collection. It noted that while the function of the ATO is to enforce and administer the law based on the 'rule of law' and in a manner which advances the objectives of timely, consistent and objective administration of the law, it did not believe that the ATO culture is consistent with this.

The G100 submitted that while the ATO states that applying the rule of law is a key value, there was a need to have robust governance and risk frameworks capable of overseeing management to ensure that the ATO embraces and 'lives out' such values.

The G100 submission also presented the results of a high level survey of its members that suggested a strong culture within the ATO, manifested in senior executives as well as other tax officers, whose sense of public duty results in a culture whereby maximising the revenue wherever possible becomes the key, if not primary, objective.

The Business Coalition for Tax Reform also believed that the ATO, at times, was inclined to adopt technical positions which would result in greater revenue collection if upheld,



which often surprised tax practitioners in the sense that they had thought the law was settled, and which were regarded by many as being inconsistent with policy.

Importantly, beyond the establishment of a management board, the Business Coalition for Tax Reform considered that active steps need to be taken to bring in suitably experienced private sector personnel to fill roles at Commissioner and Second Commissioner level so as to bring in a much needed fresh perspective to the ATO.

### **4.3 UNDERLYING CONCERNS REGARDING THE ATO'S CAPABILITIES AND APPROACHES**

The IGT's consultative process, combined with the reports of previous IGT reviews, provide a useful input when considering the deeper issues that might underlie the tensions in tax administration and the calls for improvements to the ATO governance arrangements by business and tax professionals.

The principles of good tax administration mentioned in the explanatory memorandum to the IGT Act – namely, fairness, transparency, simplicity and efficiency – are subscribed to by the ATO. However, these principles are perceived sometimes to succumb to the pressure of other forces such as resources, capabilities, complexity, revenue collection and sometimes to the design of the system itself. The IGT also supports stakeholder views that an injection of a wider range of experiences and perspectives into the governance and management of the ATO would assist in responding to these pressures.

Over the years, the ATO has established a substantial public consultation framework with the community and the profession in the development of its work initiatives. It should also be recognised that there has been an increase in the external independent scrutineering function over the ATO during that time. Scrutineer reviews and related reporting, including those of the Ombudsman, the ANAO and the IGT, have also been important additions to the tax system. The increased participation of private-sector stakeholders in ATO consultation and scrutineer functions improve transparency, accountability, technical decision making and practical robustness of the system.

Notwithstanding the above ATO initiatives, the IGT notes that concerns about tax administration continue to surface from the business sector, especially from medium to large businesses and from those that represent them. This may in part be due to the large business sector being subjected to more compliance action by the ATO, but it may also be due to the smaller taxpayers (including individuals) not being as well equipped as the business sector to identify and raise any collective or individual concerns.

Underlying concerns from the business sector relate to the ATO's capabilities and approaches in developing and applying its view of the law in significant compliance issues or on new laws. In addition, the business sector often expresses concern over a prevailing, unchecked compliance influence in the approaches and actions of the ATO.



These aspects of tax administration have also arisen as significant factors in several IGT reviews.<sup>4</sup>

Taxpayers are more likely to perceive fair treatment where the ATO openly considers whether it has contributed to specific problems. In the course of community consultations, many taxpayers and tax professionals expressed the view that ATO 'gloss' on tax disputes erodes confidence in the tax system and believed that the ATO should openly acknowledge both its positive and negative involvement. It has been suggested that the ATO should do more to report the full reality of its return on active compliance investment, factor community perceptions into its risk analyses, and potentially re-focus its resources to achieve better voluntary compliance at reduced costs to the community.

The IGT is currently reviewing the ATO's compliance focus on Small to Medium Enterprises, its implementation of recommendations arising out of the Treasury's *Review on Aspects of Income Tax Self-Assessment* and the ATO's use of early and alternative dispute resolution. The IGT notes that in the course of these current reviews a number of taxpayer concerns, which were previously raised, have resurfaced.

#### **4.4 PREVIOUS REVIEWS THAT CONSIDERED ATO GOVERNANCE ARRANGEMENTS**

The Joint Standing Committee of Public Accounts (as it then was) in 1993 considered the need to restructure the senior management structure of the ATO. It believed that the administration of the ATO and the taxation system generally would benefit significantly from the injection of opinions and strategies developed externally to the culture of the ATO and from the strengthening and formalisation of tax advisory committees.<sup>5</sup>

The IGT notes that a management board to oversee the ATO was proposed at the time of the Ralph Review and supported by professional bodies. Ultimately, the Ralph Review did not believe the establishment of a policy-constrained board of directors would be helpful to either government or the business community. The Review saw a need to have an independent and business-focused advisory Board of Taxation to assist up front in the development of clear and improved business taxation policy processes and in monitoring the performance of the administrative functions against the Taxpayers' Charter. The Ralph Review, in not favouring a board responsible for the administration of the ATO, believed that the Board of Taxation approach offered the prospect of greater certainty and less conflict in the downstream administration of business tax laws and therefore would minimise the problems which had given rise to the requests for external control over the administration of the ATO.

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4 For example, *ATO Management of Part IVC Litigation, Potential Revenue Bias in Private Binding Rulings, Settlement of Active Compliance Activities, Delayed or Changed ATO Advice on Significant Issues (the so-called 'U-turns' review), Private Binding Advice, Public Binding Advice and Large Business Risk Review and Audit Policies, Procedures and Practices*.

5 Joint Standing Committee of Public Accounts, 326th Report: *An assessment of tax – An inquiry into the Australian Taxation Office*, Canberra, 1993.

It should be noted that, at that time, the decision to proceed with the Board of Taxation and leave ATO governance arrangements unchanged may have been influenced by the impending introduction of substantial tax policy reform and that the focus, rightly, was more on achieving the right policy rather than the administration of the new policy or law. The growing support for reforming ATO governance arrangements amongst business taxpayers and tax professionals, together with the continued surfacing of concerns regarding the ATO's capabilities and approaches, would indicate that we now need to also consider ways of further improving tax administration in Australia.

## **4.5 LIMITATIONS OF ASPECTS OF CURRENT ATO GOVERNANCE ARRANGEMENTS**

### **4.5.1 Reliance on consultative forums**

The ATO publicly places strong emphasis on consultation and engagement with stakeholders in the care and management of the tax system as a means to embed trust and confidence. The ATO has established a large number of consultative forums to ensure that it understands external perspectives. The Commissioner of Taxation reports using around 50 consultative forums with taxpayer, business and tax professional representatives to foster good compliance and to reduce compliance costs.

However, the sole reliance on consultative forums as a governance process needs re-examining in light of the ongoing stakeholder concerns with aspects of the ATO's administration, including its capabilities and approaches.

First, consultative forums only provide an input into ATO decision-making, allowing stakeholders to identify and raise problems and concerns. However, there is some dissatisfaction with the degree to which such input is reflected in the final outcome. In an IGT review context, the ATO's handling of over 60 examples of perceived 'U-turns', many of which were raised at ATO consultative forums, suggests that the ATO consultation process is not a complete solution for taxpayers and their representatives to voice and address concerns.

Second, the effectiveness of consultative forums relies upon tax officers taking on board issues and concerns raised by taxpayer, business and tax professional representatives and advancing them through the ATO decision-making hierarchy. This is not considered to be a substitute for an injection of taxpayer, business and tax profession experiences and perspectives within senior ATO management.

### **4.5.2 Role of Parliament**

As noted by Dr Ken Henry in his speech '*Confidence in the operation of the tax system*'<sup>6</sup> the ultimate 'owners' of the Australian tax system are the Australian community. Parliament might be thought of as the community's ultimate board of directors, with the

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6 Henry, K., "*Confidence in the operation of the tax system*", speech delivered to the Taxation Institute of Australia conference on 13 March 2009, Sydney, available at <[www.taxreview.treasury.gov.au](http://www.taxreview.treasury.gov.au)>.

Commissioner being accountable to it for the administration of his office. The Commissioner also appears before parliamentary committees to explain his administration of the tax laws such as during Senate estimates hearings and the biannual hearings of the Joint Committee of Public Accounts and Audit.

The parliamentary committee process has significant practical limitations in scrutinising the ATO (due to the ATO's size, scope and complexity in function). A review of ATO administration often requires significant amounts of information, judgement and interpretation, which also includes the examination of case files, correspondence, internal ATO communications and tax officer meetings. The parliamentary review process is not designed for that level of scrutiny and is often reliant upon information provided by the ATO which may not always present every perspective (as was evidenced with the ATO's *Moving On* document<sup>7</sup> and the JCPAA's findings in its *Tax Administration* report<sup>8</sup>).

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

## 5. OPTIONS FOR REFORM

The IGT believes that there is merit in establishing comprehensive ATO governance arrangements in line with international tax administration developments and community expectations.

There is growing support for the tax system to inject a wider range of experiences and perspectives into ATO management. This is evidenced by the ongoing community feedback together with the wide ranging issues investigated by the IGT and previous parliamentary committee reports. A great majority of the systemic issues identified by the IGT may have been better handled if there was a greater appreciation of taxpayer and business perspectives.

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

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7 Australian Taxation Office, *Moving On*, 50.1 Supplementary submission to submission 50 into the JCPAA Inquiry reviewing a range of taxation issues within Australia, June 2006, available at <[www.aph.gov.au](http://www.aph.gov.au)>.

8 Joint Committee of Public Accounts and Audit, *Report 410 Tax Administration*, Canberra, 2008.

The key objective of any governance changes should be to promote greater representation of taxpayer, business and tax professionals' perspectives at the senior levels of tax administration. It should allow for the better fulfilment of the administrative design principles espoused in the Ralph Report – namely engendering taxpayer trust, facilitating and enforcing taxpayer compliance and ensuring a responsive administration.

The IGT believes that the following options should be considered in an attempt to improve ATO governance arrangements:

1. Establishment of a management board (such as those of an advisory or supervisory nature) to bring a diverse mix of expertise, experience and skills from across both public and private sector into the ATO including areas such as information technology, human resources, finance and communication;
2. Appointment of additional Second Commissioners from the private sector to diversify the ATO Executive Committee, inject a wider range of experiences and perspectives and provide intelligence on trends in corporate governance and taxation risks; and
3. Enhancement and centralisation of the ATO scrutineer function to provide a single port-of-call for all taxpayer concerns or grievances about the ATO.

The optimal outcome is expected to be achieved by implementing all three options listed above as an integrated package, providing synergistic benefits beyond the options as stand-alone considerations. Whilst a board has strong stakeholder support, the IGT would suggest that for the type of systemic issues identified by business and tax professionals, options 2 and 3 should also be considered.

## **5.1 OPTION 1 — ESTABLISHMENT OF A MANAGEMENT BOARD**

The ongoing international trend towards a comprehensive set of governance arrangements consisting of a management board provides a good starting point. Other government agencies have already moved down this path with some examples including the Reserve Bank, the Australian Prudential Regulation Authority (APRA) Risk Management and Audit Committee and Australian Securities and Investments Commission (ASIC).

The establishment of a management board will have number of positive influences in tax administration. It will bring a diverse mix of expertise and skills from across both public and private sector into the ATO in areas such as information technology, human resources, finance and communication. This is especially relevant given that the role and scale of the ATO's operations have grown substantially over the last twenty years. It will also help instil better project management skills and provide a new source of intelligence regarding business practices.

As listed by the IMF Working Paper, and drawing from the United States and the United Kingdom experience, the role and features of a management board could, amongst others:

- comprise private and public sector (including the Commissioner of Taxation) membership including non-executive directors representing the business community and other interests of government;
- provide advice on the management of the ATO including:
  - development and final approval of the ATO's overall strategy including performance indicators;
  - development and final approval of the ATO's communications strategy and sign off of significant ATO communications identified within it;
  - development and final approval of the culture and values objectives and strategies;
  - approval of the final sub-strategies for business lines and functions;
  - approval of final business plans (including the annual financial plan);
  - advising the Commissioner of Taxation on the appointment of senior executives; and
  - ensuring the strength of the management team by participating in the appointment of and advising on the ongoing competence of board members, Executive Committee members and other key appointments;
- maintain the independence and authority of the Commissioner of Taxation by:
  - the board having no authority over the administration and enforcement of tax legislation and no access to confidential taxpayer information; and
  - the Commissioner of Taxation being responsible for the day-to-day operations of the ATO.

Along with the establishment of a management board, there would be considerable advantages in also establishing a number of committees to support the board in its functions and responsibilities. One possibility, along the lines of the United Kingdom approach, would be having an Audit and Risk Committee, the People Committee and the Ethics and Responsibilities Committee. Membership of these committees would be drawn exclusively from the non-executive directors. In addition, each committee would have its own terms of reference setting out its membership, responsibilities, reporting and information requirements. Particular senior ATO staff would have to attend committee meetings and provide relevant information, data and reports to allow an in-depth examination of ATO corporate performance.

### **5.1.1 Recent Government action**

In 2009, the Government announced a review, *Australia's future tax system (AFTS)* and the IGT proposed to that review for consideration potential alternative ATO board structures.

Appendix 2 contains a diagrammatic representation of an example of a management board. It should be noted that the head of a centralised scrutineer agency (described below) would also be a member. The IGT believes that the appointment of the scrutineer agency head on the board provides an independence check and balance on the ATO's internal management as well a pro-active and real-time response to significant systemic issues.

Appendix 3 contains an example of a possible committee structure.

On 5 August 2010, the Government announced the establishment of a Tax System Advisory Board (the Board) to assist the Commissioner and the ATO Executive Committee on the general management and organisation of the ATO.

In January 2011, the Assistant Treasurer released a discussion paper setting out the design parameters for the Board and invited submissions on each of the three potential models for the Board.

In response to this discussion paper, the IGT has met with the Consultation Panel to discuss his views, in particular that the success of the Board will largely rely on the Board not just being independent but also seen to be independent. The IGT also raised the need for options 2 and 3 (mentioned above and detailed further below) to be considered.

## **5.2 OPTION 2 — DIVERSIFICATION OF THE ATO EXECUTIVE COMMITTEE**

### **5.2.1 The benefits of diversification**

The IGT considers that there are broader benefits to be realised by the diversification of the ATO Executive Committee, in addition to the suggestions noted in option 1 above.

As Dr Ken Henry noted in his speech *'Confidence in the operation of the tax system'*, a key difference between the ATO and a number of Australian regulators, including Australian Competition and Consumer Commission (ACCC), APRA and ASIC is that tax commissioners have largely been appointed from within the ranks of the ATO. This, he says, may have contributed to perceptions that the ATO could be more 'outward looking'.

The IGT also agrees with stakeholder submissions that the majority of the ATO staff, including those in senior ranks and managerial positions, have limited experience in the private sector. As a consequence, the organisational culture and mindset is fashioned from a public sector perspective. Given that the ATO interfaces directly with business, there is a real need for both parties to 'speak the same language' and have shared expectations.

Stakeholders often contrast the Australian position with that of the United States, where it is much more common and culturally accepted for professional personnel to work both inside and outside of the government revenue collection agency, being the IRS.

To address the issues identified by business and tax professionals, a board, in isolation, may not be sufficient. The overall governance structure is likely to be enhanced by the diversification in the composition of the ATO Executive Committee. To this end, the IGT



proposes the appointment of two additional Second Commissioners from the private sector to inject a wider range of experiences and perspectives into ATO management and provide intelligence and insight regarding trends in corporate governance and taxation risks.

### **5.2.2 The role and functions of the additional Second Commissioners**

The additional Second Commissioners should be full-time roles. They would be both members of the ATO management executive and be part of the day-to-day management team.

These Second Commissioners may serve the system best by having specific responsibility for particularly critical or contentious areas of tax administration. These areas may be those where the ATO's approaches, views and actions may be enhanced by having informed business perspectives and taxpayer experiences.

One such area is the ATO's objection and litigation sections. Stakeholders, by way of example, perceive that there is a lack of independent review where an ATO objection officer is located within the same business line as the original decision-maker, albeit a different section. The original decision-maker is perceived by taxpayers to have some kind of input or influence on the objection determination, either directly or indirectly, due to factors such as organisational, behavioural or social considerations.

The Joint Standing Committee of Public Accounts also reflected on this independence concern noting that it was difficult to characterise the objections process as an 'independent review' where objections officers were subject to the same culture, corporate goals and values as the rest of the ATO.<sup>9</sup>

The IGT's report into the *Underlying Causes and Management of Objections to Tax Office Decisions* found that in relatively simple matters, there was independent review but in larger, more complex, objections the line between the objections officer and original decision-maker was blurred. The IGT's report into *Large Business Audit and Risk reviews* considered similar concerns regarding the ATO's technical decision making review, where recommendation was made and accepted by the ATO for improvement.

An innovation, suggested by a wide range of stakeholders, is that the ATO should have a strong independent internal appeals or review area. The IGT sees considerable merit in this idea. While increasing the independence of review of original ATO decisions, the IGT believes that a separate appeals area would empower the ATO's in-house legal section to independently assess the evidence and prospects of a case before progressing the matter to litigation. The ATO's litigation arm would, like the Director of Public Prosecutions in criminal matters, have ultimate discretion as to which matters the ATO would litigate, which would be conceded and which should otherwise be settled. This would ensure that only genuine and fundamental disputes on interpretation or application of the law are litigated, resulting in cost savings for both government and taxpayers.

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<sup>9</sup> Joint Standing Committee of Public Accounts, above n 6, p. 325.

To achieve such an outcome, one of the additional Second Commissioners would head up this new appeals and review area, providing stakeholders with stronger assurance of independence.

The IGT notes that such a model currently exists in the IRS in the United States, with its Appeals area being empowered to separately and independently settle and pursue matters arising out of original IRS decisions.

It is appreciated that this approach may on occasions give rise to internal tensions within the ATO. The IGT considers that tensions of this nature are desirable in ensuring appropriate outcomes are achieved, thereby reducing the overall level of taxpayer disputes and the cost to the broader tax system.

In relation to the role of the other additional Second Commissioner, a number of options are available. For example, the appointment could be to a compliance role with responsibility for liaising with business, tax professionals and advisers where there is conflict or disagreement between the ATO and taxpayers. Other options may be for them to act as high level circuit-breakers within the ATO by being able to co-ordinate and drive the requisite ATO responses and be responsible for implementing changes to address identified shortcomings or to bring together key ATO decision-makers (for example, the Tax Counsel Network, centres of expertise and business lines compliance segments) where required to reach internal resolution of technical issues or disputes more quickly.

### **5.3 OPTION 3 — CENTRALISED SCRUTINEER AGENCY**

The IGT believes that a well-resourced and centralised ATO scrutineer function, incorporating best local and overseas practice, would better serve the Australian tax system.

#### **5.3.1 Benefits of a well-resourced and centralised scrutineer agency**

Under the proposed centralised model, the scrutineer would continue to play an important role in ensuring taxpayer rights are protected and would promote confidence in the integrity, transparency and accountability of the administrator. It would also provide a range of other benefits, including:

- a single port-of-call for considering taxpayers' administration issues and simplifying and improving access;
- a more holistic understanding of taxpayer issues arising in relation to their dealings with the tax system;
- prompt systemic issues identification that emerges from handling significant number of similar complaints;
- removal of overlap between the current scrutineer agencies;
- economies of scale and scope in centralising the separate scrutineer functions; and



- greater synergistic benefits for the ATO in only having a single tax administration scrutineer agency.

The centralisation provides a single port-of-call for taxpayer grievances, be they specific disputes or systemic issues. The investigation and resolution of specific taxpayer disputes would ensure the proposed central scrutineer agency has greater opportunity to foresee likely systemic issues arising and would prevent unnecessary delay in their resolution.

In relation to the ATO, it would only be subject to one scrutineer as opposed to the current model in which it is required to respond to several agencies. The multiplicity and duplication of action by scrutineers sometimes requires multiple ATO responses to aspects of the same issue. It would also arguably enable the ATO to enhance its responsiveness and reduce the cost of scrutineer engagement.<sup>10</sup>

As foreshadowed above, it is also envisaged that the head of the scrutineer agency would participate at the proposed management board level of the ATO, allowing for the proactive and timely consideration of issues and concerns rather than the more reactive nature of current scrutiny which investigates or reviews taxpayer concerns after the event. It will also encourage the scrutineer agency to play a more supporting role in tax administration, not only through responding to taxpayer concerns and issues, but also providing input to ATO senior management in its strategies and approaches.

### **5.3.2 Operational structure of new scrutineer agency**

The roles and responsibilities of the IGT and aspects of those of the Ombudsman and the ANAO (i.e. those relating to tax administration) may be brought together into one statutory agency. The functions of this taxation administration scrutineering agency would include:

- assisting taxpayers in resolving complaints and problems with the ATO;
- identifying systemic issues in which taxpayers have problems in dealings with the ATO;
- recommending proposed improvements to the ATO's administrative systems and practices in mitigating systemic issues; and
- identifying tax administration policy issues, for legislative consideration, that seek to mitigate those systemic issues.

Similar to the activities of the Ombudsman relating to tax administration, this agency would consider and investigate specific taxpayer complaints from people or businesses who believe they have been treated unfairly or unreasonably by the ATO. The aim would be to resolve complaints impartially, informally and quickly or to suggest other avenues

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<sup>10</sup> Commissioner of Taxation, "Sustaining Good Practice Tax Administration", Speech delivered to the Australasian Tax Teachers Association Conference, New Zealand on 20 January 2009. The Commissioner conservatively estimated that the cost of external scrutiny to the ATO had increased from \$2,451,235 in 2005 to \$4,157,488 in 2009.

for resolving the matter. The handling of such complaints would assist in the identification of potential systemic issues, as a number of taxpayers raising similar concerns could suggest an underlying problem.

Similar to the IGT, this agency would undertake reviews into systems established by the ATO to administer the tax laws or systems established by the tax laws and then make recommendations for the improvement of those systems.

### **5.3.3 Resourcing and Funding of the centralised scrutineer agency**

The AFTS review raised the need for the existing scrutineering functions to be resourced appropriately beyond that of the current level of funding and made recommendation accordingly.<sup>11</sup> Analysis will be required to determine the appropriate level of resourcing that is required to operate the proposed centralised agency effectively.

### **5.3.4 Reporting**

The centralised scrutineer agency reporting line would need to be considered. The reporting may be directly to Parliament and/or to Government.

Where the scrutineer agency head is on the ATO management board, there may be scope to differentiate the agency's reporting. One possibility could be along the lines of the United States TAS, where the scrutineer agency is required to provide two annual reports that would be tabled in Parliament. One report would identify the priority issues that the scrutineer agency will address in the coming fiscal year and the other would set out:

- a summary of the most serious problems encountered by taxpayers;
- findings from specific reviews undertaken on systemic tax issues and recommendations for improving tax administration; and
- other efforts to improve taxpayer experience and reduce the compliance burden.

Lastly, and consistent with the AFTS' recommendation 118,<sup>12</sup> the centralised scrutineer agency reports may also be considered by the JCPAA. This ensures Parliament receives an independent and candid report of the problems taxpayers are experiencing and the scrutineer's opinion on their redress. These reports may then be used in the scrutiny of the ATO's performance in any parliamentary review process.

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11 Treasury, Australia's future tax system—Report to the Treasurer, Canberra, 2009, recommendation 117 at pp. 663-4.

12 *ibid.*, p. 664.

## **APPENDIX 1: EXCERPTS FROM IMF WORKING PAPER**

### **ROLE OF THE MINISTER OF FINANCE**

#### **Control over the RA**

The legislated role of the minister of finance with respect to the Revenue Authority (RA) has a major impact on the governance as well as the degree of autonomy from the executive level of government. Therefore, it is critical to set out the role of the minister in terms of the control and supervision of the RA (direct control and supervision in some cases, almost nil in others), the appointment of the chair and members of the board and the CEO, the approval of the budget, and so on. If too much authority is granted to the minister in these areas, the RA will de facto have a significantly reduced autonomy; if too little authority is granted to the minister, there is a danger that the RA may lose necessary sensitivity to its inherent public sector role.

#### **Implications of corporate character**

The role for the government in a more autonomous revenue authority will be much more limited than would be the case for a RA which was not a 'body corporate' and which was in effect directly subordinated to the minister of finance. For this kind of RA, a first consideration is in regard to the board. Clearly, the government is the 'shareholder' of the corporate body (the RA) and therefore needs to have a say in the appointment of those who will govern that body. There are two aspects to this: the appointment of the chair of the board and its members; and the appointment of the CEO.

#### **Relationship to CEO**

The position of CEO is one of the most important in the RA, and the CEO will in effect have a dual set of accountabilities. He or she will be subordinate to the board in terms of the management; however, he or she will also be directly accountable to the legislature and to the government for the execution of all the operational powers and functions assigned to the RA by virtue of the tax and customs laws.

#### **Power of directive**

Many government institutions that have been established as corporate bodies, including RAs, include a provision for the minister to issue a directive to that corporate body. This kind of provision allows the government as the effective shareholder to direct that some particular action be done. Any such direction requires maximum transparency, usually through publication in a country's official gazette. The argument in favour of these kinds of mechanisms is that they maintain a certain amount of executive level authority and accountability without materially affecting the autonomous nature of the RA, since the expectation is they would be rarely used.

## **Role of the board**

RAs normally have a board whose functions and powers form an essential part of the organization's governance framework. Such boards can be advisory in nature, usually in cases where the minister has a strong role and autonomy is more limited, or they can be management boards with strong functions set out in legislation. Boards are almost always prohibited from involvement in the operational execution of the tax and customs laws, and from access to any information about individuals or corporations obtained as a result of the administration and enforcement of those laws. To do otherwise would place the (private sector) members of the board in an obvious and untenable potential conflict of interest situation.

## **Board functions**

The role and functions of the board flow directly from the legislation. Board functions, again depending on degree of autonomy, could include the following: to oversee the administration, management, and organization of the RA; to oversee the management of resources, services, property, personnel, and contracts; to approve the strategic plans and the budget of the RA; to approve the annual report; to establish policies to be followed; to establish by-laws for the functioning and operations of the board. In general, the board will have the power to execute all the authorities of RA with respect to carrying out the board's mandate.

## **Board meetings**

The chair will normally preside over the board's meetings and exercise the powers and functions as prescribed by by-laws established by the board under its legislated authority.

## **Ex-officio members**

A board has many duties and functions to perform and requires a mixture of skills and experiences in order to be effective. As a RA remains a government institution, it is often considered advisable to include certain government representatives on the board. In order to ensure autonomy at the same time, these positions are usually based on the notion of fixed ex-officio, or non-voting, appointments. This will respect the principle that all (voting) members of the board are required to act strictly in the best interests of the organisation, and not represent the interests of some other constituency.

## **The CEO**

In the context of corporate governance, there is a debate as to whether the CEO should also be a member of the board. The CEO of the RA has a critical role to play and has an important relationship with the board, as well as with the minister of finance in terms of the revenue laws. Careful consideration needs to be given to the most effective role for the CEO on the board.

## **Selection of board members**

In the interest of ensuring sufficient capacity on the board, the legislation should clearly indicate that all members of the board must have the experience and knowledge required for discharging their functions, normally in finance, accounting, taxation, public administration, law, or some other related field.

## **Size of the board**

Considerable debate has also taken place concerning the optimum size for corporate boards. It would appear from the literature that boards of 7 to 12 members are now being considered optimal in terms of the efficient and effective functioning of corporate boards. Larger boards than this are considered unwieldy; smaller ones are felt to be too narrow and tending to lack comprehensive skills.

## **Role of the CEO**

Powers vested in CEO. The CEO is generally responsible for supervising and managing the day-to-day operations of the RA. The management authority of the organization is embodied in the board, and in that respect the CEO, even though possibly a member of the board, is subordinated to it. However, the RA also has the mandate for the execution and enforcement of the revenue legislation, and the board will be prohibited from involvement in these areas. It is possible, then, to have an RA where the CEO only has responsibility over the areas where the board has a mandate, and where the heads of the revenue departments retain their powers and functions directly from the respective legislation.

At issue here is the extent to which all the powers and obligations related to the revenue laws (such as the power to assess taxes, make a customs determination, issue interpretations, impose or waive penalties, and so on) are actually given to the CEO through the enabling legislation of the revenue authority, who in turn delegates them to other senior officials and staff, or whether they are still given directly to the departmental heads, which serves to exclude the CEO from operations (this was a feature of some early RAs).

## **Accountability to the government**

Although RAs are intended to have independence from the public sector, it is important that they retain accountability to the government as a public institution. After all, an RA, despite its independence, continues to perform critical public sector functions. It is thus essential to establish appropriate accountability mechanisms that reflect the desired degree of autonomy for the organization. It is generally felt that the greater the autonomy of the RA from the public service, the greater the need for unique, structured, and transparent accountability mechanisms in the legislation.

In the government context, laws assign responsibility and authority to organizations and individuals within them, and these organizations and individuals are held accountable for the effective and efficient performance of their responsibilities according to the governance framework established for them. Many of the aspects discussed earlier in this paper constitute in effect accountability mechanisms to serve this purpose.

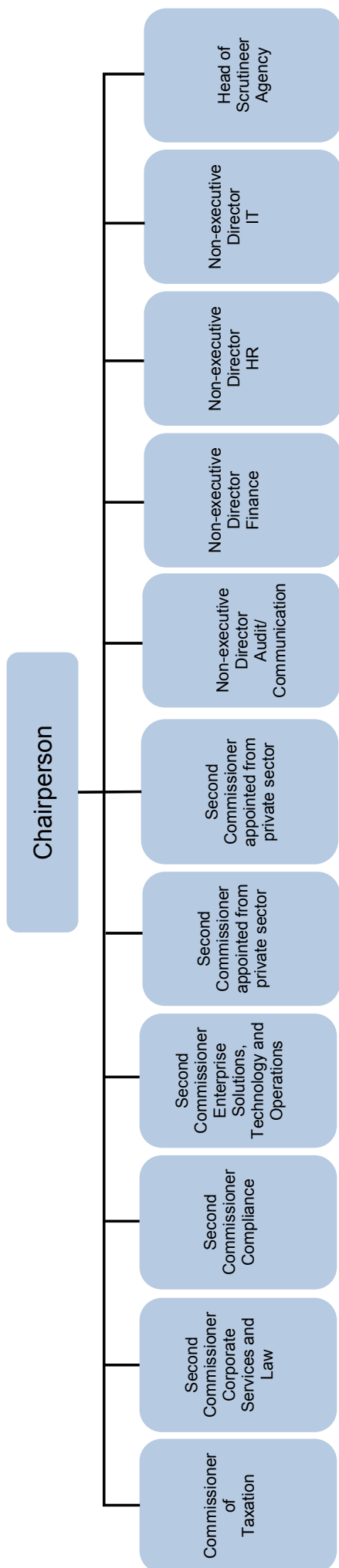
## **Internal and external audit**

A first element concerns the issue of auditing, both internal and external. As for internal audit, it is generally accepted that boards of RAs will have an active role in reviewing the outputs of internal audit (including internal affairs) in order to be able to exercise their management responsibilities, and that the organization should have an independent internal audit function reporting directly to the CEO (there is some current debate as to whether internal audit should report to the board). An RA must also have external audit. There are two choices for external audit—either the board appoints the external auditor, or the auditor general of the country, which reports to parliament, is named the external auditor for the RA.

## **Reporting to parliament**

Providing formal reports to parliament is another means of ensuring accountability to both the parliament and the executive. The two most common forms of reporting are through the annual corporate plan and budget (a look ahead at what the RA plans to do in the coming year) and the annual report (a look back at what was accomplished in the year past). Such documents provide valuable information to the government and the parliament, to ensure transparency.

## APPENDIX 2: EXAMPLE OF A MANAGEMENT BOARD STRUCTURE



### APPENDIX 3: EXAMPLE OF COMMITTEE STRUCTURE

