

## Biannual meetings

### Introduction

- 2.1 At its hearing with the Australian Taxation Office (ATO) for the inquiry on 9 November 2006, the Committee raised with the Commissioner the possibility of holding regular, biannual meetings. The Committee noted that the ATO would benefit from having a formal occasion to have ongoing and regular communication with the community.
- 2.2 The House of Representatives Standing Committee on Economics, Finance and Public Administration has set a precedent in its meetings with the Reserve Bank. This Committee believes such a model can be adapted to the ATO.<sup>1</sup>
- 2.3 In response, the Commissioner stated, 'We are happy to be open and accountable.'<sup>2</sup> He also said:

We talk about an open and accountable tax administration and that is part of the accountability processes. In fact, the way I see things is that generally – and I do not think anybody disputes this – there is a good message, a positive story to be told, about the standard of tax administration in this country. We might be able to garner the support of people such as the parliament to say that we have a tax administration that is rated as amongst the best in the world and that means we should have some confidence and trust

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1 Other examples are the relationships between the Joint Standing Committee on Electoral Matters and the Australian Electoral Commission and the Parliamentary Joint Committee on Corporations and Financial Services and the Australian Securities and Investments Commission.

2 D'Ascenzo M, transcript, 9 November 2006, p 32.

in the system, albeit we cannot be complacent and albeit there is always room for improvement.<sup>3</sup>

- 2.4 The Committee held its first public hearings with the Commissioner in Melbourne on 20 April 2007, in Canberra on 21 September 2007, and in Sydney on 30 April 2008. The transcripts of proceedings and the ATO's submissions are available on the Parliament's website.<sup>4</sup>
- 2.5 The biannual hearings will provide an important forum for Parliament to discuss key and emerging issues with the ATO. They will also provide an opportunity for the Commissioner to outline the ATO's forward plans.
- 2.6 The conduct of these meetings is likely to evolve over time with changes in tax policy, legislation, administration and technology. The Committee is open to feedback and comment from the public in maximising the value of these hearings.

## Risks for the Tax Office

### A compliance culture among taxpayers

- 2.7 At the commencement of the first hearing, the Committee asked the ATO what the greatest risk to the revenue is. The Commissioner argued that the most important task for the ATO was to promote a compliance culture among taxpayers. He stated:

I think the greatest risk to revenue is if we ultimately do not maintain and enhance the high levels of voluntary compliance that we have in this country. The trick to good tax administration is to focus on how you maintain that culture of good compliance, both within your own country and with people who interact with the country. To do that you need high levels of confidence. Those high levels of confidence are reflected by a very well-rounded program that has not just focus on active compliance or enforcement activities but also on providing support, assistance and education. It also focuses on trying to make it easy for taxpayers to comply. It does have, at the end of it, a very important role in trying to

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3 Id, pp 31-32.

4 See <http://www.aph.gov.au/house/committee/jpaa/reports.htm>.

ensure that we support honest taxpayers by having effective deterrent strategies.<sup>5</sup>

2.8 The Commissioner expanded on this during the third meeting, suggesting that developing a compliance culture is a community-wide responsibility:

It would be to get that cultural change in the community – it cannot be led by the tax office but it can be led by people who are influential in the community – to indicate that basically the tax and super systems are there to support Australians. The way that they should operate both at an administrative level and at an individual level should not be adversarial. If things are seen to be disadvantageous to the system and to the community as a whole, people should stand up and make sure that they are counted. I think people have stood back and said, 'It is not my responsibility.'<sup>6</sup>

2.9 As part of the compliance culture overview during the first meeting, the Commissioner noted three priority risks for the ATO:

- restructuring, mergers and acquisitions in the large business sector
- non-reported cash payments between consumers and firms in the small business sector
- supporting the compliance model in the small business sector, such as ensuring small businesses know how to comply and making it easier for them to do so.<sup>7</sup>

## The superannuation guarantee

2.10 In its submission to the first meeting, the ATO identified employers' compliance with the superannuation guarantee as an increased risk for 2007-08. The issue is that some employers do not pay their employees' superannuation, as required by law.<sup>8</sup>

2.11 The following statistics demonstrate that this is a major concern for the ATO:

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5 First biannual meeting with the Commissioner of Taxation, D'Ascenzo M, transcript, 20 April 2007, p 4.

6 Third biannual meeting with the Commissioner of Taxation, D'Ascenzo M, transcript, 30 April 2008, p 30.

7 Id, p 5.

8 First biannual meeting with the Commissioner of Taxation, ATO, sub 1, p 29.

- In 2006-07, the ATO raised \$349.8 million in superannuation guarantees and collected \$237.8 million of this <sup>9</sup>
- 20% of the complaints that the Ombudsman receives about the ATO relate to the guarantee (the highest category of all complaints) <sup>10</sup>
- it receives approximately 10,000 complaints per annum on employers' compliance with the guarantee <sup>11</sup>
- the ATO investigated over 20,000 cases in 2006-07.<sup>12</sup>

2.12 In evidence, the ATO stated that the area with the most compliance issues was the non-incorporated business sector.<sup>13</sup> It also noted that it is educating taxpayers to monitor their superannuation more often. Notifying the ATO earlier means that it is in a better position to assist taxpayers:

One of the frustrations for us is that we often do not hear from employees until after they have left employment. So apart from the fact that we are, with this additional funding, covering 100 per cent of any complaints to us, we are also trying to market very strongly to employees to check their contribution statement every year and to talk to us quickly if they are having no success with their employer. We cannot check every employer in the community. We certainly are lifting our game in relation to the number of employers we can look at, but we also need that help in terms of people letting us know more quickly, before things have developed.<sup>14</sup>

2.13 The ATO gave an indication of the practical difficulties they face in following up many of these complaints:

I would say that one of the challenges we have is that something like 60 to 65 per cent often come in after the person has left the employment. A typical example I could give you is a complaint I

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9 ATO, *Annual Report 2006-07*, p 138.

10 Commonwealth Ombudsman, sub 38.2, p 1.

11 First biannual meeting with the Commissioner of Taxation, Granger J, transcript, 20 April 2007, p 8.

12 First biannual meeting with the Commissioner of Taxation, D'Ascenzo M, transcript, 20 April 2007, p 8.

13 Ibid.

14 First biannual meeting with the Commissioner of Taxation, Granger J, transcript, 20 April 2007, p 22.

looked at recently which came in in 2006 but was for the 10 years up to 2002.<sup>15</sup>

- 2.14 The 2007 Budget allocated \$125.7 million over four years in new funding for the ATO to further pursue tax debts and unpaid superannuation.<sup>16</sup> The ATO stated in evidence that this would allow it to pursue every superannuation debt down to \$100.<sup>17</sup> The ATO reported at the third meeting that there has been a decrease in the number of outstanding superannuation guarantee debt cases.<sup>18</sup>
- 2.15 The Government and Parliament have made it easier for the ATO to manage these complaints. Under section 45 of the *Superannuation Guarantee (Administration) Act 1992*, the ATO is unable to divulge an employer's superannuation affairs to someone else. This also applies to investigating complaints about the superannuation guarantee.
- 2.16 In 2007, the Government and Parliament inserted section 45A into the Act. This section allows the ATO to give information to an employee or past employee who has made a complaint against their employer. The information must relate to the complaint, including the following:
- the ATO's actions to investigate the complaint
  - the ATO's actions under the *Superannuation Guarantee (Administration) Act 1992* and the *Taxation Administration Act 1953* (for example, to assist it in enforcing compliance)
  - the ATO's actions to recover the superannuation amounts.

## The cash economy

- 2.17 In its submission for the first meeting, the ATO stated that the cash economy was an increased risk in 2007-08, in particular for business to consumer transactions. The ATO also noted that this risk was endemic and would require attention well into the future.<sup>19</sup>

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15 Second biannual meeting with the Commissioner of Taxation, Vivian R, transcript, 21 September 2007, p 7.

16 Hon P Dutton MP, Minister for Revenue and the Assistant Treasurer, 'Tax Office debt collection enhancement – Reducing taxation debt and outstanding superannuation guarantee charge payments', Press Release, 8 May 2007, viewed on 4 July 2007 at <http://assistant.treasurer.gov.au/pcd/content/pressreleases/2007/055.asp>.

17 Second biannual meeting with the Commissioner of Taxation, Crawford M, transcript, 21 September 2007, p 10.

18 Third biannual meeting with the Commissioner of Taxation, D'Ascenzo M, transcript, 30 April 2008, p 2.

19 First biannual meeting with the Commissioner of Taxation, ATO, sub 1, p 29.

- 2.18 The Committee asked the ATO whether it would be able to quantify the size of the cash economy or the amount of tax lost through the cash economy. The ATO stated that the Australian Bureau of Statistics has done some work in the area, but it prefers to manage the risk, rather than focus on the amounts involved.<sup>20</sup> Further, the ATO said that there is currently a debate over how to measure the tax gap and there are high costs on honest taxpayers:

The US does surveys which are based on random audits. The difficulty for us in doing that and why we have gone down the other methodology path has been that to have a statistically relevant sample would be very resource intensive in terms of the overall program and it would also mean auditing people who are compliant, which we feel would be an unacceptable community cost. Having said that, there is an OECD working party of which we are members that is working through what ought to be a standard approach to measurement, whether it is done by a revenue authority or outside a revenue authority. As you can imagine, there is a fair bit of debate about what will be in those processes. We are part of that working party and we are engaging in what might be a good measure.<sup>21</sup>

- 2.19 The Committee supports the ATO's involvement in this international research and believes there would be value in developing a robust estimate of the cash economy and foregone tax more generally. Achieving international consensus should help in producing a robust methodology.

### Release 3 of the Change Program

- 2.20 Over the past few years, the ATO has been updating its information technology processes and systems. The ATO describes this major project as its Change Program. The ATO finalised the first component, Release 1, in 2005. Release 2 followed in 2006 and Release 3 was scheduled to commence in January 2008. These projects are increasing in scale. The number of person days they have required has increased from 24,000 for Release 1 to 68,000 person days and 290,000 person days respectively.<sup>22</sup>

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20 First biannual meeting with the Commissioner of Taxation, D'Ascenzo M, transcript, 20 April 2007, p 6.

21 First biannual meeting with the Commissioner of Taxation, Granger J, transcript, 20 April 2007, p 13.

22 Second biannual meeting with the Commissioner of Taxation, ATO, sub 1, p 5.

- 2.21 Following Release 2, the ATO obtained advice from Capgemini, a consultancy, on its performance. Capgemini reported that the ATO had managed this large-scale project well:

The ATO should be pleased that such a complex systems deployment, both in terms of functionality and numbers of end users, has been largely successful. To put the scale of this deployment into perspective, the rollout to over 10,000 ATO staff is some ten times larger than what we typically see in the Australian marketplace, where Siebel based systems deployments are usually more staged, and involve user communities of only 1,000 to 2,000 in each 'drop' of functionality. As far as we can ascertain, this is the largest rollout of Siebel Case functionality globally.<sup>23</sup>

- 2.22 The ATO has identified various aspects of the Change Program as risks.<sup>24</sup> Release 3 places additional risk on the ATO because of its scale and because it involves replacing all of the ATO's core processing systems. The ATO reports that it has mitigating strategies in place and has been consulting with tax professionals and small business on possible impacts. Recognising that the transition will not be seamless, the ATO has lowered some service standards for 2007-08.<sup>25</sup>

- 2.23 Although the Change Program involves costs in 2007-08, the aim is for the ATO to be more efficient in the long term. Capgemini has confirmed this:

The 'pain' associated with the introduction of such complex systems, however, is balanced by the advantages to be gained long term by the ATO through the establishment of new enterprise wide process models. The software provides the ATO with a long term infrastructure platform on which to further develop functionality and deploy new processes throughout the organisation.<sup>26</sup>

- 2.24 The Committee awaits the roll out of Release 3.

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23 First biannual meeting with the Commissioner of Taxation, Capgemini, correspondence, 22 November 2006, exhibit 12, p 1.

24 First biannual meeting with the Commissioner of Taxation, ATO, sub 1, p 32.

25 Second biannual meeting with the Commissioner of Taxation, ATO, sub 1, p 5.

26 First biannual meeting with the Commissioner of Taxation, Capgemini, correspondence, 22 November 2006, exhibit 12, p 2.

## E-commerce

- 2.25 The development of new technologies and new markets raises the question of whether they represent new risks to the revenue. The Committee asked the ATO whether electronic commerce and internet transactions had created new risks for the ATO. The agency responded that it is monitoring e-commerce, but it does not represent a high risk at this stage:

Australia has been at the forefront of doing some early thinking in the area of e-commerce. In fact, we drafted the OECD's two reports on e-commerce back in the late nineties. We have found that the impact of e-commerce has not been as dramatic in the Australian context as we had expected. At the moment it is not high on our lists in terms of risk to the revenue. It is something that has to be monitored. The recent newspaper articles that saw our activity in connection with people using internet type transactions shows that we are active in that field, but at this stage in aggregate figures it has not been as much of a concern to Australia as was predicted. But it is one of those areas that could very easily inflate over time.

One of the things about e-commerce is that, if it is in relation to goods and services, you do have something tangible that you can apply your own activities to. So the risk to e-commerce comes more at the services, copyrighting, tangible end of our activities. If it is done through large companies, it falls within transfer pricing reviews that remain a high priority for us.<sup>27</sup>

## Specific issues discussed during the hearings

### Agribusiness managed investment schemes

- 2.26 Managed investment schemes are commercial arrangements where investors put funds into a plantation to secure an interest in a pooled enterprise. Members do not have day to day control over the scheme and pay management fees to a service company. These fees tend to be very high in the first year of operation. The main attraction of the investment is

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27 First biannual meeting with the Commissioner of Taxation, D'Ascenzo M, transcript, 20 April 2007, p 5. Transfer pricing occurs where related entities make an international transaction and, for example, adjust the price to reduce the profit of the Australian entity and reduce tax paid in Australia.



that these initial fees are often tax deductible as expenses, rather than needing to be depreciated over time. In practice, the main legal requirement that taxpayers needed to meet to qualify for the deduction was they had to demonstrate that they were carrying on a business.<sup>28</sup>

- 2.27 The Committee understands that the schemes can be useful to taxpayers with an unexpectedly high income in a financial year. Taxpayers can easily lower their income for that year through the one-off deduction.
- 2.28 The two main types of investment in these schemes are in forestry and agribusiness (for example olives, almonds and avocados). One reason behind the tax advantage for forestry plantations is that establishment costs are high, but the plantation only earns cash at harvesting, many years later. An early tax deduction helps offset the long period before the taxpayer earns income.<sup>29</sup>
- 2.29 In December 2006, the previous Government announced that it would continue the tax advantage for forestry managed investment schemes, provided the schemes met certain conditions. The Government stated it would introduce a specific clause in the tax law to allow the deduction. Taxpayers would not need to demonstrate that they were carrying on a business.<sup>30</sup>
- 2.30 However, in February 2007, the Government announced that it would not continue the deduction for agribusiness. It noted that the ATO had changed its view of the law to the effect that taxpayers investing in these schemes were not carrying on a business. The ATO would stop issuing product rulings allowing the deduction from 1 July 2007 and would release a draft ruling to reflect its new view of the law.<sup>31</sup>
- 2.31 The announcement sparked considerable debate. Shares in agribusiness companies dropped significantly. In policy terms, some argued that the schemes distorted markets and the Government should drop the

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28 ATO, 'Income tax: Registered agricultural managed investment schemes' TR 2007/D2, paras 3, 5, viewed on 4 July 2007 at <http://law.ato.gov.au/atolaw/view.htm?DocID=DTR%2FTR2007D2%2FNAT%2FATO%2F0001>.

29 Nielson L, Hicks P, *Tax Laws Amendment (2007 Measures No. 3) Bill 2007*, Bills Digest no. 159 2006-07, 23 May 2007, Department of Parliamentary Services, p 20.

30 Hon P Dutton MP, Minister for Revenue and Assistant Treasurer, Hon Senator E Abetz, Minister for Fisheries, Forestry and Conservation, 'Review of the taxation of plantation forestry,' Press Release, 21 December 2006, viewed on 4 July 2007 at <http://assistant.treasurer.gov.au/pcd/content/pressreleases/2006/097.asp>.

31 Hon P Dutton, Minister for Revenue and Assistant Treasurer, 'Non-forestry managed investment schemes,' Press Release, 6 February 2007, viewed on 4 July 2007 at <http://assistant.treasurer.gov.au/pcd/content/pressreleases/2007/007.asp>.

deduction. Others argued that the tax advantage helped regional Australia cope with the drought.<sup>32</sup>

2.32 Stakeholders also criticised the process. One agribusiness firm alleged that the Government did not meaningfully consult with industry. This was despite the Government and the ATO holding discussions with the industry in 2006, where the ATO advised the industry of its new view of the law.<sup>33</sup> On 27 March 2007, the ATO announced that it would extend the transition period by 12 months to 30 June 2008.<sup>34</sup>

2.33 The Committee asked the ATO to account for its conduct in this matter:

What we have actually had is indications from the court – one by the Supreme Court in *Environ* and another one by the Federal Court in *Puzey* – to say that our view of the law was wrong...

[This] has taken some time. We then referred the matter to government because it was really a government issue of how it wanted these areas taxed. The government made its decision in relation to afforestation and decided that we should just test the law – it said it would not do anything in relation to agriculture or agribusiness. That left the tax office with views expressed by the judiciary that our previous view was not right. We have gone through an extensive process of trying to review our position. We think a better view now is that we were wrong. Therefore, we are trying now to have a test case to clarify that over the next 12 months.<sup>35</sup>

2.34 The Committee accepts that, once the ATO has decided that its previous view of the law is incorrect, it needs to commence a process to introduce its new view of the law. As discussed previously in this report, the Committee believes that giving taxpayers up to 12 months to adjust to new arrangements is a good base position.

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32 Irvine J, 'Plantation tax lurk gets chop, shares crash,' *Sydney Morning Herald*, 8 February 2007, p 24.

33 Ibid, Hon P Dutton, Minister for Revenue and Assistant Treasurer, 'Non-forestry managed investment schemes,' Press Release, 6 February 2007, viewed on 4 July 2007 at <http://assistant.treasurer.gov.au/pcd/content/pressreleases/2007/007.asp>.

34 ATO, 'Transitional arrangements for agribusiness managed investment schemes,' Media release 2007/09, viewed on 20 March 2008 at <http://www.ato.gov.au/corporate/content.asp?doc=/content/00095911.htm>.

35 First biannual meeting with the Commissioner of Taxation, D'Ascenzo M, transcript, 20 April 2007, pp 12-13.

## Allegations of BAS and identity fraud

2.35 Prior to the hearing on 20 April 2007, the media reported that criminal interests had received \$5 billion since 2003 in fraudulent BAS claims. Once a taxpayer is registered for GST, they can claim large amounts of GST in business supplies that the ATO credits to them. If they do not collect GST in business sales to offset GST paid, then the ATO pays them a refund. The media reports alleged that the ATO did not have sufficient controls on taxpayers initially registering for GST.<sup>36</sup>

2.36 The Commissioner rebutted the allegations as follows:

It was in a report by an ex-officer which extrapolated figures that did not have any firm basis. There does not seem to be any dip of anything like that order in our collections. We have a range of specific checks and balances and in fact some of the claims that were made in that report are not correct or do not reflect the level of checks and balances that we have. We have had ANAO review ... our refund approaches and, again, that did not indicate any defect of the order that was mentioned. My answer to that is: we have not seen any reliability in that figure and we do have checks and balances that we think are working reasonably well.<sup>37</sup>

2.37 The ATO stated that refunds are occasionally delayed due to the checking processes it has installed to reduce the incidence of fraud.<sup>38</sup>

2.38 One of the key tests in a taxpayer registering for GST is for them to confirm their identity. The ATO stated that it is educating the community about the need for individuals to protect their private information. Further, it continues to monitor identity fraud:

We have said in terms of this area of refund fraud that one of our real concerns is also the associated identity fraud that goes on. You may well have heard that we campaign quite a bit with both the agents and the community more generally about the care they need to take with their private information. To put identity fraud in context when we are talking about this issue, there were about 120 cases we investigated last year. So it is not big numbers but it is the kind of thing that everyone needs to be vigilant about. As I

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36 Baker R, 'Crime gangs rort \$5 billion in tax office refunds,' *Age*, 26 March 2007, p 3.

37 First biannual meeting with the Commissioner of Taxation, D'Ascenzo M, transcript, 20 April 2007, pp 6-7.

38 First biannual meeting with the Commissioner of Taxation, Granger J, transcript, 20 April 2007, p 7.

said, we have significant checks, but that is something that is under continuous scrutiny for us.<sup>39</sup>

- 2.39 The Committee notes that the ATO monitors BAS and identity fraud and supports it continuing to review and investigate suspicious activity.

## Private equity buyouts

- 2.40 There has been debate in Australia about private equity buyouts of public companies. One aspect of the debate was whether the Australian Government loses revenue overall. Firstly, the profitability of these companies (and the tax they pay) is reduced in the short term by paying higher interest charges on the debt raised to purchase them. Further, the previous Government took a policy decision not to tax capital gains when foreign investors sell local businesses at a profit. On the other hand, the Government will receive extra revenue up front if shareholders make a profit when they sell out to the private equity team.<sup>40</sup>

- 2.41 The Committee asked the ATO whether these buyouts are subject to the anti-avoidance provisions in the tax legislation. The ATO responded that private equity buyouts are usually legitimate financial arrangements:

I am not sure that they are necessarily arrangements of that ilk. If they are for the purpose of avoiding tax and if our anti avoidance provisions apply then we will apply them, but if it is just someone who has a loan from overseas, and pays interest on that loan, to acquire a business activity in Australia for the purpose of deriving assessable income then that deduction would be deductible.<sup>41</sup>

- 2.42 The Senate Standing Committee on Economics has recently completed an inquiry into private equity, including its revenue implications.<sup>42</sup>

## Communication with tax agents and their clients

- 2.43 The Committee raised with the ATO the issue of how it communicated with tax agents and their clients. In particular, the Committee was concerned about instances where the ATO sent notices to clients but not to their agent. The Committee suggested to the ATO that it could send

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39 Ibid.

40 Knight E, 'How privateers can sail through the tax system,' *Sydney Morning Herald*, 23 March 2007, p 21.

41 First biannual meeting with the Commissioner of Taxation, D'Ascenzo M, transcript, 20 April 2007, p 17.

42 Senate Standing Committee on Economics, *Private equity investment in Australia* (2007)

notices to both groups. The ATO responded that tax agents have a fair degree of control in managing this correspondence:

We consult with tax agents and have been consulting with them for five or six years about this topic. We have built a facility which allows them to specify the postal address for different types of notices if they choose to do so, and they do use it a lot. Some agents, for example, ask that all pay-as-you-go withholding material, which applies to a taxpayer's employment obligations, go directly to the taxpayer, because they are not interested in being a part of that. However, it still comes up from time to time. It plays out in two ways. Firstly, sometimes agents complain to us that we send them a lot of material about new initiatives such as choice and super guarantee and things of that nature. We have sent it to the postal address and they do not necessarily want it; they have to send it on. Secondly, we also have to be careful because taxpayers sometimes complain that we send material to their agent and it is not forwarded on to them. Sometimes warnings that we send out are not forwarded. So we make judgements about some particular mail-outs. The general rule, though, is that accountants are able to control the direction of the great majority of our correspondence.<sup>43</sup>

- 2.44 The Committee supports the ATO's consultations in this area and believes the ATO should continue to discuss these issues with tax agents.

## Phoenixing

- 2.45 While discussing compliance with the superannuation guarantee charge, the ATO raised the problem of 'phoenixing'.<sup>44</sup> This occurs when a business owner intentionally lets their firm fail, along with its debts. When the owner commences a new business, it is difficult for past debtors to collect the money owing to them. This is because the owner's assets reside in a different entity (the new business) from that which the debtor has a contractual relationship (the old business).

- 2.46 The ATO stated that phoenixing was a significant problem:

Phoenixing is a blight on the Australian economy and a not insignificant burden on the tax system. We have officers who

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43 First biannual meeting with the Commissioner of Taxation, Konza M, transcript, 20 April 2007, p 18.

44 Second biannual meeting with the Commissioner of Taxation, Vivian R, transcript, 21 September 2007, p 8.

chase up very significant phoenix cases and try and get criminal prosecutions for fraud and that sort of thing, but a \$10,000 super guarantee debt would not figure very highly. But it is a very significant problem.<sup>45</sup>

2.47 The ATO also noted that phoenixing mainly occurred amongst micro and medium firms, but was not limited to any one industry:

I think it is mainly in the micro and medium segments of the economy because the larger businesses cannot afford the risk to their reputations. In the past, you could almost have said it was rife in the building and construction industry, but we have put a lot of effort into that over the last seven or eight years. We think that the practice has declined a bit in that industry, but it has spread to other industries – labour hire firms are one example that comes to mind. There are some accountants, for example, who advise people on how to do this, so it is perpetuating mischief in that respect.<sup>46</sup>

2.48 The Committee is concerned that some accountants are advising clients on how to phoenix their businesses. Currently, the main sanction against such conduct in the tax agent legislation is cancellation or suspension of registration.<sup>47</sup> The exposure draft legislation for tax agent regulation released this year proposes a Code of Conduct that includes a requirement for agents to behave honestly and with integrity. Breaches of the Code attract a wider range of sanctions, including:

- a written caution
- completing a course of training
- an order to provide only certain types of tax agent services
- an order to provide services only under the supervision of a particular tax agent.<sup>48</sup>

2.49 In the view of the Committee, there is a discrepancy between the approach taken in the promoter penalties legislation and the proposed arrangements for tax agents. In particular, promoters of tax evasion schemes can be subject to civil penalties of 5,000 penalty units for an individual to

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45 Second biannual meeting with the Commissioner of Taxation, Konza M, transcript, 21 September 2007, p 9.

46 Second biannual meeting with the Commissioner of Taxation, Konza M, transcript, 21 September 2007, p 10.

47 Section 251K of the *Income Tax Assessment Act 1936*.

48 Treasury, Exposure draft, *Tax Agents Services Bill 2008*, clause 30-20.

25,000 penalty units for a corporation if they are promoting a tax exploitation scheme.<sup>49</sup> Promoting a scheme may be potentially more damaging to the compliance culture and the revenue (compared with only advising a client base). However, the Committee is of the view that misconduct in advising clients of evasion schemes such as phoenixing is sufficiently serious to warrant the same type of penalty. If an advisor's clients are sufficiently wealthy, then the revenue and public confidence in the tax system can be compromised to a similar extent. Civil penalties should be available for advisors who engage in misconduct such as instructing clients in phoenixing and similar practices.

- 2.50 There may be other legislation that would result in these accountants being subject to civil penalties. The Australian Securities and Investments Commission may have a role as well. Alternatively, the promoter penalties legislation may have wide operation. In any event, the main outcome that the Committee is seeking is for these advisers to be subject to civil penalties and that they are enforced in practice. The Committee is content for the Government to determine the best way of achieving this, be it via legislation or a change in regulatory focus.

## Recommendation 2

- 2.51 **The Government ensure that tax agents who give advice on tax evasion techniques, such as phoenixing, are subject to civil penalties, either through new legislation or enforcement of existing legislation.**

- 2.52 The ATO gave the Committee some data on the extent of its Phoenix compliance work:

During the period July 2001 to March 2008 we finalised 1,118 audits of businesses which were involved in serial Phoenix behaviour.

During the year ended 30 June 2007, Phoenix Project teams raised over \$93 million in tax and penalties from the finalisation of 234 cases, of which \$76 million was in respect to tax and \$16.1 million was in respect to penalties and interest.

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49 Sections 290-50 and 290-65 of the *Taxation Administration Act 1953*. Under section 4AA of the *Crimes Act 1914*, the current value of a penalty unit is \$110. Broadly, a tax exploitation scheme is an arrangement entered into with the sole or dominant purpose of reducing tax and is not reasonably arguable at law.

In the past few years 10 company directors have been successfully prosecuted for participating in Phoenix-related activities. The Courts have showed wide variation in the sentences handed down. For example, in 2001 a bricklaying contractor was gaoled for 7 years 8 months for defrauding over \$7 million in pay as you earn (PAYE) monies. In a more recent case a previously banned and bankrupted formwork contractor received 9 months 'home detention' plus a Reparation Order of \$50,000 for failing to remit \$1.6 million in PAYE monies. His home detention 'conditions' actually permitted him to continue to visit his work premises on a daily basis.<sup>50</sup>

- 2.53 The Committee strongly disapproves of phoenixing. It fully supports ATO efforts to investigate and prosecute any reported instances of such practices.

## Liechtenstein bank records

- 2.54 In early 2008, the media reported that an ex-employee of a Liechtenstein bank, LGT Group, had sold client information to the German authorities.<sup>51</sup> Liechtenstein is a declared tax haven<sup>52</sup> and this information has a high potential value to tax authorities around the world.
- 2.55 The ATO has received some of this information and has commenced 20 audits in response.<sup>53</sup> In evidence, the ATO confirmed that it had received the information and was acting on it.<sup>54</sup> Given that this data is potentially stolen goods, the Committee asked the ATO to confirm that its conduct was appropriate. The ATO stated:

Sometimes we get information from a range of people who may have got it through other means. Often we do not go behind the information that is provided to us. Provided we are not party to the illegal means, the [legal] advice ... is that we should be using it.<sup>55</sup>

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50 Third biannual meeting with the Commissioner of Taxation, ATO, sub 2, p 2.

51 Drummond M, 'Send a thief to catch a thief,' *Australian Financial Review*, 1 March 2008, p 30.

52 ATO, *Tax havens and tax administration*, (2007) p 8.

53 Third biannual meeting with the Commissioner of Taxation, ATO, sub 1, p 12.

54 Third biannual meeting with the Commissioner of Taxation, D'Ascenzo M, transcript, 30 April 2008, p 6.

55 Third biannual meeting with the Commissioner of Taxation, D'Ascenzo M, transcript, 30 April 2008, p 8.



- 2.56 The Committee also raised the issue of how the ATO would use the information. In relation to whether the data would be admissible in court, the ATO responded:

I think there are questions about admissibility. I do not think we have got a yes or no answer there. The proposition in Australia is that it is up to the discretion of the judge, and so it will be a matter of how the judge sees the circumstances of this information, if we were to use it in the legal sense.<sup>56</sup>

- 2.57 However, the ATO may not need to present this information in court, but instead use it as a way of conducting investigations that produce admissible information. The ATO noted:

I think it is important to make the point that the first way in which we use any information we obtain is to undertake a risk assessment, and it will be one of a number of factors. We do profiling and have a look and then approach the taxpayer, depending on the circumstances of the case. So it is not just a question of: is information available to use in court; the very first place it gets used is to evaluate whether there is a tax risk here that needs to be investigated further. By the time you might get to an outcome and where there is going to be any dispute, that may not necessarily be a source of information we need to rely on.<sup>57</sup>

- 2.58 The Committee again disapproves of taxpayers using tax havens to fraudulently avoid their Australian tax obligations. However, the use of potentially stolen material is a delicate matter. The Committee encourages the ATO to not only ensure that it is acting within the letter of the law but that the wider community will view its actions as fair and appropriate.<sup>58</sup>

## Security of taxpayer information

- 2.59 In December 2007, the ATO announced that it had commissioned PricewaterhouseCoopers to review its information security practices. The ATO decided to undertake the review following some minor incidents at

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56 Ibid.

57 Third biannual meeting with the Commissioner of Taxation, Granger J, transcript, 30 April 2008, p 8.

58 For an overview of the ATO's operations in relation to tax havens, see ANAO, *The Australian Taxation Office's Strategies to Address Tax Haven Compliance Risks*, Audit Report No. 36 2008-09, 29 May 2008.

the ATO and a major incident at its counterpart in the United Kingdom where the details of 25 million taxpayers were reportedly lost in the post.<sup>59</sup>

- 2.60 The ATO released the full report on 8 May 2008, shortly after the third biannual meeting. At the meeting, the ATO gave the Committee a summary of the review's findings:

The PricewaterhouseCoopers review reinforced to us that our current policies and practices were generally very sound. We have a very strong culture of protecting sensitive information within the tax office. That was reinforced by the fact that even when we have incidents people talk about those and will openly come forward and say, 'This was an incident,' so that we can then look at what the root causes were.

The review emphasised that we need to raise awareness further in our officers and confirm that arrangements with other agencies in terms of interchange are sound and up to the current environment. Ten years ago, we would not have exchanged information to the extent that we do today. There are a number of broad-ranging recommendations, but there is nothing fundamentally broken within our existing policies and procedures. It is more about reinforcement, training and so forth.<sup>60</sup>

- 2.61 The Committee congratulates the ATO for actively addressing this potentially serious matter.

## The Inspector-General's report on private rulings

- 2.62 In February this year, the Inspector-General of Taxation finalised his report on potential bias in complex private rulings. Following a review of the ATO's processes, the Inspector-General concluded that there was no evidence of undue revenue bias.<sup>61</sup>
- 2.63 However, the Inspector-General found clear evidence of perceptions of ATO bias among taxpayers and taxation bodies. The Inspector-General concluded that this was due to a lack of ATO transparency and communication with taxpayers. Part of this problem was caused by the ATO's relationship with Treasury, in particular the confidentiality of the

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59 O'Toole C, 'Tax Office checks security after bungles,' *Australian Financial Review*, 6 December 2007, p 6.

60 Third biannual meeting with the Commissioner of Taxation, Gibson B, transcript, 30 April 2008, p 9.

61 Inspector-General of Taxation, *Review of the potential revenue bias in private binding rulings involving large complex matters* (2008) Commonwealth of Australia, p 3.

communications between them. The ATO declined to implement the Inspector-General's recommendation to advise taxpayers of the content of its discussions with Treasury. However, it did agree to advise taxpayers when these consultations were occurring.<sup>62</sup>

- 2.64 At the third biannual meeting, the ATO gave a number of reasons for maintaining confidentiality. The first was that communications between government and administration need to be confidential. The Commissioner stated:

While it is put as advice to Treasury, when we are talking to Treasury we are talking to government. It is independent, but we are saying: 'Government, this is what we are seeing in terms of the law. We suggest that you may want to change the law one way or the other.' In providing advice to government, the normal protocol is that those communications between administration and government are confidential. That is the protocol that has always been in force. Otherwise, you would get into a situation where you have the government put under some pressure with the administration saying, 'You need to change the law here,' when the government does not want to change the law. You need to have that confidentiality when we are advising the government. It is the normal advice that government will accept from external parties or internal parties on a confidence basis. They say, 'We will listen to this advice if it's confidential.'<sup>63</sup>

- 2.65 In the view of the Committee, there are two counter arguments. Firstly, the ATO's communications with government often involve a third party, namely a taxpayer. The Committee accepts that governments conduct confidential policy discussions with stakeholders regularly. One reason to accept confidentiality is that these discussions are often hypothetical. But once a taxpayer is involved, the discussions take a practical character. It is difficult for the ATO to demonstrate that a taxpayer has received natural justice when they are unaware of information contained in these communications between the ATO and Treasury.

- 2.66 Secondly, the Commissioner appears to be stating that the ATO should not put the government under pressure through Treasury to change the law if the government does not wish to. If the ATO is an impartial administrator of the law, then the government's reluctance to change certain laws may not necessarily be relevant to the ATO's conduct.

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62 Id, pp 4-7, 124.

63 Third biannual meeting with the Commissioner of Taxation, D'Ascenzo M, transcript, 30 April 2008, p 18.

Government, which represents the democratic majority, may be a better institution to be responsible for these decisions. Another institution that represents the democratic majority is the Parliament. There may be scope in future for this Committee to use the biannual meetings and its developing relationship with the ATO to work through some of these legal and policy issues. Ultimately, Parliament makes the tax laws.

- 2.67 The Commissioner made further arguments in favour of the confidentiality of ATO and Treasury communications at the hearing.<sup>64</sup> On this occasion, it is not necessary for the Committee to make a conclusion, apart from stating that there are arguments both for and against the confidentiality of discussions between the ATO and Treasury. Any further examination will most likely depend on the extent to which it is raised in future by taxpayers, the Inspector-General and other scrutineers.

## Conclusion

- 2.68 The Committee is pleased with the progress of the biannual meetings. The Committee has been able to hold the ATO to account in relation to topical tax issues and the ATO has had the opportunity to present its side of the story.
- 2.69 In some cases, such as the Liechtenstein bank records and allegations of BAS and identity fraud, the ATO has provided a reasonable explanation of its conduct. On other matters, such as the security of taxpayer information and the superannuation guarantee, the ATO has demonstrated that it is taking corrective action.
- 2.70 The biannual process demonstrates to the Committee that the ATO addresses some issues over time. For example, at the first meeting the superannuation guarantee was a high profile problem.<sup>65</sup> At the second meeting the ATO had received extra funding to address it and at the third meeting the ATO was reducing the backlog. The Committee will be able to track progress on issues like this at each hearing and looks forward to continuing the process in future.

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64 Id, pp 19-23.

65 Kazi E, 'ATO warns dodgy bosses' *Australian Financial Review*, 21 April 2007, p 3.

