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JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

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JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

Monday, 13 October 2003

Members: Mr Charles (*Chair*), Senators Hogg, Humphries, Lundy, Murray, Scullion and Watson and Mr Ciobo, Mr Cobb, Mr Georgiou, Ms Grierson, Mr Griffin, Ms Catherine King, Mr Peter King, Ms Plibersek and Mr Somlyay

Senators and members in attendance: Mr Charles, Ms Catherine King, Ms Plibersek and Mr Somlyay

Terms of reference for the inquiry:

Review of Auditor-General's report, fourth quarter 2002-03.

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BARLOW, Mr Christopher John, Assistant Commissioner, Serious Non-Compliance, Australian Taxation Office	1
CASS, Mrs Barbara, Senior Director, Performance Audit Services Group, Australian National Audit Office	1
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Committee met at 10.48 a.m.

BARLOW, Mr Christopher John, Assistant Commissioner, Serious Non-Compliance, Australian Taxation Office

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MANN, Mr Neil Edward, Deputy Commissioner, Small Business, Australian Taxation Office

RUSSELL, Mr Barrie Thomas, Deputy Commissioner, Goods and Services Tax, Australian Taxation Office

CHAIRMAN—I open today's public hearing, which is the fifth in a series of hearings to examine reports tabled by the Auditor-General in the financial year 2002-03. This morning we will be taking evidence on Audit report No. 55: *Goods and services tax fraud prevention and control*.

We will run today's session in a roundtable format. I ask participants to observe strictly a number of procedural rules. First, only members of the committee may put questions to witnesses if this hearing is to constitute formal proceedings of the parliament and attract parliamentary privilege. If other participants wish to raise issues for discussion, I would ask them to direct their comments to me, and the committee will decide if it wishes to pursue the matter. It will not be possible for participants directly to respond to each other. Second, given the length of the program, statements and comments by witnesses should be relevant and succinct—and I emphasise 'succinct'.

Third, I remind witnesses that the hearings today are legal proceedings of the parliament and warrant the same respect as proceedings of the House itself. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of parliament. The evidence given today will be recorded by Hansard and will attract parliamentary privilege. Finally, I refer any members of the press who are present to the committee's statement about the broadcasting of proceedings. In particular, I draw the media's attention to the need to report fairly and accurately the proceedings of the committee. Copies of this committee statement are available from secretariat staff.

I welcome representatives from the Australian Taxation Office and Australian National Audit Office to today's hearing. Ladies and gentlemen, thank you very much for coming. I thank the ATO for their brief submission. Do you have a very brief opening statement?

Ms Granger—Very brief: we will not be making one, thank you.

CHAIRMAN—The committee commented on an earlier report and asked for a better definition of fraud. As I told our friends from the Australian National Audit Office—and you from the tax office are also our friends, of course; as always—I have had concern over some time that the definition we use for fraud is not definitive, that it is too loose to really tell us what was happening. The issue came to my attention when we were looking at ATO fraud reviews. When we were looking at the tax office and internal fraud, the situation came up where you found somebody looking at a computer screen at somebody's tax file and they were not using it for fraudulent purposes—that is, to extract money, favours, goods in kind or anything else—but simply out of curiosity. For instance, I might be a tax officer and I might be interested in Kerry Packer's reporting of his income and, just for the heck of it, I have a look—and, at the time, that was being reported as fraud. It is my view that, if you then go and compare Australian fraud statistics with those of Indonesia or Botswana, we would have a problem, because we would look very fraudulent and they would probably look very clean, which is not very sensible.

It is the committee's understanding that the Commonwealth guidelines define fraud as 'dishonestly obtaining a benefit, both tangible and intangible, by deception or other means'—and that applies to the Australian Taxation Office. Is that definitive enough?

Ms Granger—I will talk broadly and then I will ask Mr Mann to go into some more detail. There is a difficulty we experience—and we have seen it in the ANAO report. Certainly we operate within that definition and we have publicised that and circulated to our staff. In responding to the various actions that may be taken, we have a range of administrative responses that have been legislatively provided to us—up to and including prosecution. The area where we have difficulty is at the borderline of where you make the decision about what you deal with administratively and what you refer to prosecution.

As you would know from that very definition and indeed the Director of Public Prosecutions' guidelines, there is not a mathematical formula where you can say, 'All of these add up to fraud.' It is always going to be a balance to decide what to do in your most serious cases. It will balance things such as ability to successfully prosecute, compliance history and a whole range of those things. So what we give to our staff is a range of factors for them to be able to decide. There are certain things we make mandatory. For example, if there is clear evidence that there have been false records, that is a clear referral for investigation. But in the wash-up from that, as to what is involved and whether there has been loss, there is a whole range of factors that get taken into account about where it sits in the process. I am not sure we are ever going to get to an absolutely clear definition, because there is going to have to be a judgment.

CHAIRMAN—Let me pose a couple of examples.

Mr SOMLYAY—Before you go on, are the DPP guidelines an arrangement between ATO and DPP, or are they general guidelines?

Ms Granger—They are general guidelines.

Mr SOMLYAY—Can we get a copy of those?

Ms Granger—Certainly.

CHAIRMAN—If I am an ironing lady, I do your ironing, you pay me in cash and I do not report GST, is that a fraud?

Mr Mann—For fraud, we would need to see intent to defraud. When we do our general compliance activities, we are looking to see whether people are aware of their obligations, whether a woman in that situation would be required to register—

CHAIRMAN—Is that lack of compliance or fraud?

Mr Mann—On the face of it, we would treat that as a compliance issue unless we found an intent to defraud or some deception in those arrangements.

CHAIRMAN—If I am a carpenter and I build an extension on your house and tell you that if you give me cash I will charge you less than if you pay me by cheque, but without any idea of whether I am claiming back input tax on the materials that I bought, is that fraud?

Ms Granger—As Mr Mann said, when we shift to the criminal, whether we can prove this criminally involves intention. If you have clear intention there and we can back that up with evidence, then yes.

CHAIRMAN—So it does not matter whether I am input taxed or not input taxed, as long as my intention—

Ms Granger—If your intention is to defraud, to deceive, as it says—

CHAIRMAN—If my intention is to avoid being in the GST loop other than having to pay GST on the materials that I buy—on the extension I have built for you—that is fraud.

Ms Granger—But a lot of what we see is much less black and white than that in terms of—

Ms PLIBERSEK—Can you give us some examples of cases that have fallen into the grey area?

Ms Granger—Chris Barlow can probably give you more detail.

Mr Barlow—Could I just make one point, going back to your original assertion—to look at the definition that is in the Commonwealth fraud control guidelines and basically say, ‘How does that help us, and is that useful in comparing internationally or whatever?’ I would agree with you. It is an extremely wide definition. It basically covers just about anything that we come across in a tax environment. If someone claims a donation for \$50 knowing that that is not something they have incurred, theoretically, under the definition, that would be a fraud.

Ms PLIBERSEK—It is, isn't it?

Mr Barlow—Yes.

Ms PLIBERSEK—Practically, that is a fraud, isn't it?

Mr Barlow—It is, yes.

Ms PLIBERSEK—But you are not going to prosecute?

Mr Barlow—But how would we know that it was done intentionally unless we actually go and interview them and ascertain that they have done it intentionally. It may have just been a mistake. You do not know. From our perspective, if someone has claimed a deduction they are not entitled to, we do not know if they did it with intent or if it was an innocent error. At that first cut, before we actually look at something, just about anything that you see first of all could potentially be a fraud. The definition is quite problematic for us.

CHAIRMAN—Do you compare our data collection systems—your fraud control engine for what we define as fraud in the area that the tax office is responsible for—with those of other countries? How do we come up with common definitions and what defines accountability, transparency and lack of fraud?

Mr Barlow—Certainly, from a GST perspective, I am travelling to London at the end of this week to do just that. We are comparing ourselves with—

CHAIRMAN—Why don't you try Indonesia, China or Thailand?

Mr Barlow—We look for areas of similar jurisdiction.

CHAIRMAN—They do have GST. Everybody has GST.

Mr Barlow—Our advice is that Canada and the UK in particular are probably the best examples for us. We did some work initially, in the setting up of the GST business line, to assess those issues.

Mr Russell—Certainly in the lead-up to GST we did a scan of what was in place in a number of benchmark countries. We looked at Singapore as the most modern technological implementation at the time, we looked at New Zealand as a policy model for the GST, we looked at the UK as a very mature system and we looked at Canada as the best demographic fit for the Australian context. We also reviewed OECD papers and reviews and European Union arrangements. That is basically how we designed our initial compliance program around GST. We took into account the lessons from those jurisdictions, some of which were dealt with by a different approach to the legislation, others of which we dealt with by particular risk management techniques.

CHAIRMAN—But if you look at trading partners you see that our largest trading partner is the United States, which does not have a GST. There is Japan, which certainly does. China is

third, and it does too; it is quite large, 21 per cent or 22 per cent. Why don't we have a look at the ones that we trade with who might have different definitions from ours?

Mr Russell—There is limit to the resource angle of that, but we tend to look at jurisdictions that we believe are in some way comparable to the Australian context. Japan has a different type of VAT. China, in terms of the development of its tax administration, is probably not yet at the level of a number of the developed countries that we have examined.

CHAIRMAN—But one of these days they will become our largest trading partner.

Mr Russell—Yes.

CHAIRMAN—It seems to me that one of the things that this committee is always concerned with is accountability. That is the big word for us—accountability. If we cannot compare Australia in context with the countries we trade with, I would think that puts us behind a bit in terms of being able to demonstrate how accountable we are. Am I wrong?

Mr Russell—I would go back to my previous answer around having comparable jurisdictions. Certainly we benchmark with a number of overseas countries that we do believe are comparable to the OECD. We have a formal performance agreement with the states and territories.

Ms PLIBERSEK—The point that they are making is that you are using trading partners as the point of comparison but there are economies that are more similar to ours and there are tax systems that are more similar to ours. You cannot benchmark—

CHAIRMAN—I accept that, but I would like to know how we compare with the developing part of the world.

Ms PLIBERSEK—We are probably better.

CHAIRMAN—I expect that we are, but I would like to know where we stand, that is all. Can you tell us about your fraud rating engine?

Mr Russell—Risk rating engine?

CHAIRMAN—Yes.

Mr SOMLYAY—Before you go to that, can I ask a question.

CHAIRMAN—I do not know if you can, but you may.

Mr SOMLYAY—I will. I refer to ANAO report No. 35 back in 2002, addressing the cash economy. I think some academics put the value of the cash economy somewhere between \$5.4 billion and \$20.7 billion. Does that send shivers up the spine of the ATO? Have you any empirical evidence as to what the real figure might be—a guesstimate? If the cash economy is worth that, there is big potential for a lot more fraud control.

Mr Mann—The way we approach it is to try to get some reasonable working hypotheses for us as administrators in terms of the extent of that revenue fraud and how we might best tackle it. The fact of the matter is that there is not any agreed methodology to estimate the size of that cash economy. We certainly do monitor academic research and also work done by the Australian Bureau of Statistics and international research. We do not see that it is particularly useful to try to pluck a figure out of the air, but in terms of the work that we have done over the years we have estimated our activities probably at the lower end of those ranges. We look to what the ABS say. I do not know if you have seen the latest ABS paper on this topic, but they say that estimates towards the lower end appear to be more reasonable in terms of their understanding of the size and nature of our economy. Where we get to is that it is significant. It is certainly talking about billions, but as to whether it is one, two, three or more billions of tax revenue—

Mr SOMLYAY—And successful prosecutions amount to \$10 million.

Mr Mann—Yes, but what we do is use the administrative approaches available to us to make inroads into that non-declaration of income. That is through things like the introduction of the Australian business number, the requirement for businesses to withhold at the top marginal rate from other businesses not quoting an Australian business number, chasing up the audit trail between parties using the GST, and having broad based field presence verifying not only the businesses' records but also their transactions with their suppliers and customers. That is where we are bringing to account revenue that would otherwise be missing.

Mr SOMLYAY—So that figure includes GST, income tax—

Mr Mann—Those figures are trying to estimate, I believe, an income tax revenue leakage from those estimates that have been made by a range of academics. They are expressed, I believe, in what the ANAO converted into an income tax estimate.

CHAIRMAN—Income; not company tax and GST?

Mr Mann—It would include company taxes and income taxes of sole traders.

Ms PLIBERSEK—I would like to go back. Mr Barlow was going to give us some examples of grey areas where you are not quite sure whether it is fraud or serious non-compliance. I am interested in some practical examples?

Mr Barlow—I am trying to think of a schemes case, which is a particularly relevant issue at the moment and has been over the last few years—something like an employee retention plan arrangement. If you see the documents, when you first look at them, if they are all put into place as they are represented, you may not have a fraud, because there is an arguable position—

Ms PLIBERSEK—Sorry, can I take you back a step. An employee retention scheme, did you say?

Mr Barlow—I am thinking of a case where someone claims a deduction against a business income for an expense to retain an employee and it is structured in a particular way with loans and what have you. If you just look at those documents when you first get them, and they are signed and you believe those transactions were entered into at that particular time and all the

parties have signed them, you may think that you do not have a fraud. However, when you start to investigate, there may be elements of backdating of documents, perhaps even false signatures put on documents, or creation of explanations after the event, which taint the whole process and where it is definitely a fraud.

Ms PLIBERSEK—But this is not a GST fraud.

Mr Barlow—No, that is a broader example.

Ms PLIBERSEK—How about a GST fraud versus a GST serious non-compliance?

Mr Barlow—You may have a circumstance where someone claims a GST credit. That is the most prevalent type of fraud. They have to have an invoice that backs up that credit—that says they have actually incurred that expenditure. Then there may be issues around the veracity of that invoice. Sometimes it may be a concoction between non-arms-length parties and there are questions about the valuation of the transaction. When you are not at arm's length, they can agree on a particular value. Then that is facilitated by the accruals versus cash basis that you can use for GST. If one party uses the accruals basis, another party uses the cash basis and there is non-arms-length valuation of the transaction, there is a potential for fraud.

Ms PLIBERSEK—But surely, if you have a situation like that set up, you have clear intention to defraud, haven't you?

Mr Barlow—If you can prove it. You might prove it by the surrounding circumstances such as the value. If the value is \$30 million for an Internet site which we might be able to prove is probably only worth \$3,000 or something, then those sorts of things go to show that the parties are not acting in a bona fide way. You are very lucky if you get a written statement that says, 'I'm going to defraud the ATO.' You have to infer it from a whole set of circumstances. That is what is difficult about the definition of fraud. Until you get all those things together and you have gotten over that hump of beyond reasonable doubt for a criminal prosecution, fraud is a very difficult offence to prove.

Mr Russell—I might just add an example in the GST context. It might help. We often have people claiming input tax credits when they do not hold a valid tax invoice, which is one of the requirements of the law. Normally, we would treat that as a compliance issue and deal with it administratively. Infrequently we come across people who might actually manufacture false documents to support such claims. That would start to take you into the area of fraud.

CHAIRMAN—I understand that. That makes logical sense. On the one hand, it is compliance, and on the other, because you actually created a document, it is fraud. Are you going to be able to get around to giving us some advice on how we come up with a generic definition of fraud that is more workable and helpful, that is more internationally acceptable and comparable?

Ms Granger—We, of course, have to operate within the Commonwealth definition of fraud.

CHAIRMAN—I understand that, but you are allowed as individuals to make any suggestions to us that you like.

Ms Granger—Certainly where we are working we have talked about some aspects of how you make that decision. There are also other elements that go into the decision, such as the triviality, whether it is the first time, have they otherwise been a good complier—a whole range of those things. I do not think I am going to give you the satisfaction of saying there will be an exact type definition. We have quite good on-the-ground referral guidelines for our staff. We have the Commonwealth definition here, and we are working on, if you like, a bridging statement that brings this up and that down to, generally, ‘These are the kinds of things you can expect from us.’

It is never going to be black and white. This is an area where there has to be judgment—and you would expect judgment. If we use a sledgehammer to crack a nut, that will be as bad for public confidence as if we fail to address it. We have clearly been given a range of administrative solutions that we can use as well, and we are expected to be able to apply those in the judgments. So I do not think we will ever be in a position to give you the black and white answer. We do struggle—

Ms PLIBERSEK—You have really upset the chair!

Ms Granger—I am terribly sorry, but this is very difficult. We have said quite overtly in our guidelines that we expect, in most instances, we will be taking compliance action rather than prosecuting or referring for prosecution simply because we have a range of those things there. If we operate at the level that the taking of the pen worth a dollar is a fraud and should be prosecuted for a jail term, that would bring us into disrepute as much as if we ignored it if it were systematically happening over a number of years. I am sorry I cannot give you a definitive answer. We are going to have a go, as recommended by the ANAO, at how we get to a mid level, if you like, of explanation between those very broad Commonwealth guidelines that could pull in everything to saying this is what ‘more trivial’ looks like in our environment and this is what we mean by ‘good compliance’—those sorts of things might help our staff.

CHAIRMAN—When?

Ms Granger—We hope to have that done by the end of December. But it is not an easy area.

Mr Mann—The example that comes to mind is a company that has some debts and that may sell its assets to another company. The company that purchases those assets may claim an input tax credit. If they were related companies there might be a question: was the first company simply a poor business person who got into debt and goes into insolvency, allowing another company to claim that input tax credit quite normally? Or, if there was some sense of collusion or intention and some deception involved, then that could probably be a fraudulent activity. So it is quite hard to distinguish between a business person who simply is not very good at working out his profit margins going into insolvency and who has to dispose of his assets to another company, and a person who may enter into collusion with some other company to deliberately facilitate the claiming of an input tax credit.

Ms PLIBERSEK—Okay. That is a good example. May I continue?

CHAIRMAN—Go on, sorry. I interrupted you and that was rude.

Ms PLIBERSEK—Not at all. Who was it who said they were in charge of the serious non-compliance business line? You have started that since the ANAO audit?

Mr Barlow—We had what we called a serious non-compliance capability before that, which I headed and reported to the Deputy Commissioner for Small Business. But since that time we have now increased our focus on this area and there is actually a deputy commissioner appointed to head a new business line and I report to that deputy commissioner now.

Ms PLIBERSEK—What is the intention of changing the arrangement—the structure?

Ms Granger—I will take that question. Our serious non-compliance activities occurred in three parts of the ATO at that point in time. We had our separate internal investigation area, we had serious non-compliance, which essentially was a corporatised function for most of our revenue products, and we had a specific one for excise that came across when excise came across from Customs. We believed it was time to pull that all together into one corporatised area. We also want to review how we are doing that to see if there is anything we can do around improving our practices, tools and also resourcing and management arrangements around that. This is part and parcel of a change that we have been going through at the tax office where we have started to pull all of our divisions into various subplans, of which one is the compliance program. Serious non-compliance sits in the compliance program. As we have bedded down those new arrangements we are looking not always to structural solutions, but where we see that it is not making sense to do things in a number of areas we have pulled that together. As part of this we are looking at how we might standardise across those and also increase the critical mass because we have pooled the two areas together.

Ms PLIBERSEK—Do you feel that there is any indication that so far this is a better way of pursuing serious non-compliance?

Ms Granger—I think it will be but it is early days. We started this in July when we established the new line. We have Mr Tom Sherman having a review of processes at the moment but we believe that apart from everything else it will allow us more flexibly to deploy our investigators across the whole range because they will be working together. One of the things we are always concerned about is that you make sure the knowledge is shared across the revenue products and across the markets. This brings it all together. That should help us with insight for critical mass around our intelligence gathering et cetera but it is a bit speculative because it is early days. I am not sure if you want to add anything, Mr Mann.

Mr Mann—I will just add some examples where we are already starting to work in that way around fuel substitution and tobacco excise fraud. There are obviously other tax obligations that were involved in some of those activities so it made sense to have our investigators working together. From that experience, we are taking that further both to share intelligence about who might be conducting an activity over here that might be of concern for other reasons and also to start building an operational capacity that Ms Granger was talking about in terms of being able to more flexibly deploy people who know something about the industries and about the issues.

Ms PLIBERSEK—To clarify so that I understand it: previously you would have had one lot of investigators looking at excise, one lot looking at the GST implications and one lot looking at, say, income tax avoidance.

Ms Granger—We had already corporatised the other taxes. It was only excise that was separate so we have brought excise together with the serious non-compliance area into one serious non-compliance division. We have kept our internal investigations areas separate, so that is the only thing outside.

CHAIRMAN—Does that include personal income tax as well?

Ms Granger—Correct.

CHAIRMAN—And trusts?

Ms Granger—Yes.

Mr Barlow—I might just add that the other benefit that we hope to get from this is that we have created a corporate focus on fraud so this area actually has overall responsibility for drawing the picture together as to what is happening with fraud. We hope to bring more expertise to bear and we will identify things such as identity fraud, which is a particular issue for us at the moment. So we will deal with that on a whole-of-ATO basis. We think we will get some synergies out of that.

Ms PLIBERSEK—So the serious non-compliance is not just looking at serious non-compliance; it is looking at fraud as well, or you have a separate fraud area.

Mr Barlow—Again, because of the definitional problems, we may treat fraud in different ways. We may prosecute fraud, so we have our fraud investigators and they are within serious noncompliance. We may audit fraud and we have our special audit area that deals with fraud as well but from a civil perspective rather than an administrative perspective.

Ms PLIBERSEK—So you call it all serious noncompliance until you send the brief to the DPP?

Mr Barlow—No, we have different areas that do the work. Because of the use of our powers, we have to keep them separate, so we can only use tax powers for civil purposes. Our fraud investigators can only use criminal investigation procedures, so we do keep them separate but we want to bring capability together, because we need to be able to choose between those different strategies and use the most appropriate one for the circumstances.

Ms PLIBERSEK—The audit report mentions, what seem to be, some quite serious problems in recording and reporting. The figures that you had for potential fraud seem to vary quite substantially. Could you tell us about how you have improved recording and reporting?

Mr Barlow—Yes. We have purchased a new case management system, which will go across all the areas that deal with fraud. Those areas are our serious noncompliance area, which includes the excise investigators now, and also the fraud prevention and control area, which is the internal investigations area, and they will all be using the same case management system. That case management system will have specific fields in it to gather all of those statistics for us and reports built around the definitions as we negotiate some clarity around those definitions with the Attorney-General's Department. We certainly were chastened by our experience when

we made that error and, at the moment, we have manual processes in place to review all our statistics so that we get them right. We are putting a lot of effort into developing this case management system, which will be in place at the start of the next calendar year. We will continue to monitor it manually as well to make sure we get it right.

Ms PLIBERSEK—That will give you the ability to tell us how much potential fraud there is or will it give you the ability to tell us how much is under investigation—what sort of figures will it generate?

Mr Barlow—It will be around the cases that we are actually investigating. We will have clear definitions around the fraud that related to each of those matters.

Ms PLIBERSEK—It will be cases under investigation?

Mr Barlow—Yes.

Ms PLIBERSEK—How are you going with recovering money?

Mr Barlow—Of the fraud that we have identified, the great majority is actually stopped before it goes out of the ATO. With respect to recoveries—

Ms PLIBERSEK—Is that because of your refund integrity project?

Mr Barlow—That is because we check so many refunds. We have a very strong checking process before refunds are issued. Of the frauds that we currently have on our system—

Ms PLIBERSEK—What about people who are not paying GST in the first place—you are not recovering that money through the refund integrity project, are you?

Mr Barlow—That is correct.

Ms PLIBERSEK—You are only really getting one half of it.

Mr Barlow—We only know what we know. If people are underreporting in the first place—

Ms PLIBERSEK—How do you deal with that—the whole other part of GST fraud, which is not people claiming what they are not entitled to but people not paying what they should?

Ms Granger—We need to be careful about definitions there. Most of that would be within our normal compliance program activities and we report the results of those. In our last compliance program, we published the results, right across that program, of adjustments made and penalties raised in relation to audits where you would see most undeclared income or overclaimed deductions would be part of that process. Mr Barlow was talking to you very specifically about the ones that are referred for investigations that lead to either a result or no further action as a result of that process. Most of that would fit in there. We have published those results, so they are available if you would like us to send you a copy of our program results.

Ms PLIBERSEK—But how do you find those results? How do you discover when people are not paying the GST that they should be paying? Are you just doing random checks?

Ms Granger—Through our general compliance program. But I will ask Mr Russell to give you a brief outline of what we do in the GST context.

Mr Russell—To put it in context, when we talk about intercepting fraudulent or incorrect refunds, that is our pre-issue program. The very heavy focus we have on that comes from that overseas experience I mentioned earlier. When we did the scan internationally, the message came back very clearly that refunds were the biggest risk in the system. The reason for that is, as you know, you have this churning effect with the GST, where you pay GST upfront and then claim back input tax credits. About one-quarter of the business activity statements that we receive in any period are net credit returns, so it is a significant amount of money. In fact, in terms of refunds claimed during the year, it is something like \$25 billion. It is a major issue for us. If it is fraudulent and if it leaves the office it is very difficult to recover, so we want to intercept as much as we can. We have a very robust program around that. We complement that with a post-issue compliance program—again based on international experience and our own risk identification. It is highly targeted. The cash economy work is an example of that program. We have something like 3,000 field officers. One of the features of the new tax system was the government funding of a significantly increased field capability for the ATO. We complement the pre-issue work around refunds with a very robust and high coverage audit program around GST. We actually target 10 per cent of the population per annum.

Ms PLIBERSEK—Is that through the general compliance program?

Mr Russell—Yes.

Ms PLIBERSEK—Is that 10 per cent of the business population?

Mr Russell—It is 10 per cent of the registered population.

Ms Granger—The results for last year were: \$812 million in tax and penalties raised; \$690 million in tax collected.

Ms PLIBERSEK—Is that tax and penalties?

Ms Granger—Yes, and that is published in the compliance program.

Mr SOMLYAY—I understand what the ATO is doing within the ATO, but who is out there checking up on and finding all the cashies, as they are called in the industry. The building industry is going through a huge boom at the moment. So much cash work is going on. What is the ATO doing on the outside of the ATO to identify all those people, or some of the people, who are working in the cash economy? It is absolutely rampant in the building industry at the moment.

Mr Mann—We have about 660 field officers who focus on industries that are, in our view, at some high level of risk in terms of tax evasion in particular, and that certainly includes the omission of income from the cash economy. The building and construction industry is certainly

the industry where we have the single largest presence. Two hundred and sixty seven staff are focused just on that industry. The activities that they are engaged in range from using our internal data to identifying taxpayers who are disclosing, if you like, higher levels of expenses than businesses of their size or kind typically are. So we ask the question: 'Do we think they are reporting all of their income?' That is one way of identifying underreporting of income.

We also have staff who visit construction sites. We make sure that the parties are properly registered for GST, if required to do so. In that way, we are not limited to the data that is within the office. We follow, in particular, any major events and follow from the contractors down through the various tiers of subcontractors to make sure that there are reasonable arrangements in place for tax collection, either withholding from employees or through the contractual arrangements between contractors and subcontractors. As part of that work, we have a very high profile within employer associations, and we get information from the employee associations that leads us to look in particular areas.

Mr SOMLYAY—Have you prosecuted any of those people?

Mr Mann—Yes. If you could just give me a moment, I will try to find the report on that.

Mr SOMLYAY—And how big were they? A lot of these amounts are in hundreds rather than tens of thousands.

Mr Mann—We appeared before the Cole royal commission earlier in the year, and the information we gave there, for example, was that in the past two years over 100 individuals involved in the building and construction industry have been investigated. Thirty-nine of those in New South Wales have been or are being investigated for fraud. As a result of that—

Mr SOMLYAY—Are they fairly big operators?

Mr Mann—They are largely in formworking. It is one of the subindustries of the industry that we are particularly looking at—scaffolding would be another. We go through a range of subindustries within the industry. The issues that we have been identifying as a part of that are untaxed cash-in-hand moneys. There are fraud cases where there has been an intention to deceive and benefit from basically falsifying documents and, therefore, not paying pay as you go tax. They is also withholding amounts from employees, money laundering and provision of false or misleading statements. In most serious cases, charges are typically laid under the Crimes Act. You probably would have heard that there was quite an extensive bogus labour hire scheme in New South Wales that involved falsification of records. Four promoters, two directors and a financial administrator of formwork companies, as well as a director of a bricklaying business, were all charged.

The sentences imposed over the last few years include six fraud prosecutions. The sorts of amounts involved range between \$6 million to \$13 million in each case. The sentences that were achieved ranged from 18 months imprisonment to seven years imprisonment. Over the last few years we have seen, I believe, some indications that the courts are treating these kinds of frauds more seriously for tax purposes than perhaps when I started looking 10 years ago.

Mr SOMLYAY—I do not doubt that, but what I am asking is: when I ring up a plumber and he turns up to my place to do the job and says, ‘So much for cash; so much on invoice’—who is looking for that bloke and trying to make him comply?

Mr Mann—Obviously, most of our activities are directed to where we think the bulk of the revenue and economic activity is at. It is not, in this business, at the consumer end.

Mr SOMLYAY—But that is not a very good signal to give to the industry at the lower end.

Mr Mann—No. We have other activities, however, that try to look at the extent and nature of that risk that you are talking about. In fact, one of the ways we get this is people give us information about people they might have some questions about. We have an evasion hotline; we assess and investigate a number of those. Typically, the single largest area of investigations coming out of that is again into the building and construction industry and, typically, these sorts of issues around non-declaration of income. What we have looked at with the cases that we have found is that the story is not quite black and white, that in many cases using a cash discount is almost a marketing tool—

Ms PLIBERSEK—Bing Lee does it, and it is not because they are not paying the GST.

Mr Barlow—No, it is because of the credit card charges.

Mr Mann—What we often find is that these people do have an Australian business number and most times they are registered for GST. The fact is that they have incurred the liability to collect and remit GST on that discounted price. You have to shave off, if you like, some of the anecdotal evidence and you have to get behind and see what is actually happening in that tradesman’s own accounts. Why aren’t we more concerned? We are actually surprised about the degree to which small business people, sole traders included, who did not have an obligation to register for GST because they were earning income below the \$50,000 per annum threshold, have not only registered for an Australian business number but also gone on to register for GST. Once they do that, we have internal data that will identify whether or not we think they are returning an appropriate amount of either GST or income tax based on their level of operation as reported through the activity statement. What we have found is that many people—tens of thousands in fact—have gone through that process of registering under the new tax system and we are now going back and discovering that they have outstanding tax obligations from prior years in that they have not lodged returns in the past and we are following those up now. They will ultimately get to the sorts of people that you are talking about.

Mr SOMLYAY—Paragraph 3.36 of the ANAO report says:

The ATO has identified—

this is following on from what you have just said—

that serious non-compliance and fraud relating to ABN/GST registration and integrity is increasing.

Do you want to comment on that?

Ms Granger—In relation to GST fraud, we have predicted from the scan overseas which Mr Russell mentioned that that is typical, that from a quite slow start in the first year we would expect to see a rise. What we are seeing in terms of referrals at the moment is that it looks like plateauing after an initial year of small referrals in the very first year. Now it seems to be in a steady state. But what I would say as a corollary to that is that, as you know, we have been rebalancing our compliance program over the last year. We have publicised that. That means we will have more people in the field, and I would expect that, by its nature, as part of that that we will be detecting some more as a result of that. But it has been in a steady state over the last couple of years.

Ms KING—To follow up what you were saying before, have you had any other cases referred to you as a result of the Cole royal commission?

Mr Mann—I do not have the detail with me, but certainly we had to second staff to work on the royal commission and there is a process of dissemination from the royal commission to relevant law enforcement and other government authorities. Obviously, we have been following the public information. We have an area that assesses that and undertakes any follow-up action that we believe merits it. There is also a more formal dissemination of particular pieces of information. I would have to take on notice the formal process as to what extent we have received information.

Ms KING—But you have received some and you have been following that up?

Mr Mann—Yes.

Ms KING—I have a simple question. Can you tell me what is the value of lost tax revenue as a result of fraud? Do you have that figure?

Mr SOMLYAY—Between \$4.5 million and \$20 million.

Ms Granger—I am not sure we can say. Earlier, Mr Barlow advised that, because of the risk rating and general process that we have where we look at refunds before we go out, in fact we detect a lot before there is an actual loss. That is well over 80 per cent; it is close to 90 per cent. But it is a little bit hard because that is to try to quantify what you do not know in a sense. So I am not sure that we would have a figure.

CHAIRMAN—When you value fraud do you include penalties and interest?

Mr Barlow—For the purpose of reporting to the Attorney-General's Department?

CHAIRMAN—Yes.

Mr Barlow—No, we do not. The amount defrauded is the amount that has not been paid or that that has been claimed.

CHAIRMAN—Does the ANAO confirm that?

Mrs Cass—Yes. It is when we look at what is recovered that we consider it, where we looked at penalties and interest.

CHAIRMAN—Is it appropriate to include penalties and interest in what is recovered?

Mrs Cass—In what regard?

CHAIRMAN—If we are talking about fraud, let us go back to the earlier discussions, which perhaps got a bit esoteric but I think are important. We are talking about trying to define something which is perhaps difficult. I understand it is difficult to define, but it is about trying to get better and better at defining it in both a national and an international sense. If in one case the ATO is reporting data on GST fraud on the amount of the fraud and then, with the successful court case, it is reported on the basis of the amount of the fraud plus penalties and interest, I would have thought that we would have a data reporting and collection problem.

Mr Barlow—The formal reporting that we do to Attorney-General's is the amount of the fraud, so it does not include the penalties. Any other reporting would be things like audit results—and they are the results. We are just reporting the results from that audit activity. It may not be necessarily be linked to fraud. It would be within that category of results.

CHAIRMAN—Mr Mann, when you were answering some questions from Mr Somlyay you talked about the number of new businesses being registered. My advice from New Zealand years ago, probably in 1992, was that when they brought in their equivalent of what we call an ABN they found tens of thousands of businesses that they did not know existed. Has that, in fact, happened? Has it made a huge difference in tax revenue?

Mr Mann—We certainly found that businesses that registered for an Australian business number started reporting liabilities—GST or income tax—under the new tax system on a regular basis. We started looking at where they came from—what their prior activity was. They were not included in the initial mail-outs inviting people to register for an Australian business number. We found that they were in two groups: people who were in the tax system but their activity lapsed over the years or people who had never been registered. It is quite a dynamic market. There are always businesses that are starting up, closing down and reintegrating. But, when we looked at the group that has become active, we whittled it down to tens of thousands—at the moment we do not know—and, at this stage, we have raised around \$60 million in back taxes from those businesses. That is an ongoing program that we will be pursuing.

Mr SOMLYAY—How many ABNs did you expect to issue? How many did you issue?

Mr Mann—There are probably around 700,000 businesses that did not have a requirement to register for GST that registered for an ABN and GST. They were always entitled to register but we did not require them to do so.

Mr SOMLYAY—The point I was getting at is that we definitely had more registrations than we anticipated.

Ms Granger—Yes.

Mr SOMLYAY—Far more.

Mr Mann—Yes, but there are also other reasons in terms of the extent to which there are holding companies or other entities that might not be actively trading and do not have a tax obligation, and we were not aware of how many of those there were in the system until the ABN came along. The total increase beyond the initial mail-out cannot be attributed to finding businesses—

Ms Granger—But we are going through a process of reconciling that, for the obvious reason that it is a good source of information for us.

Mr Russell—I will just add to that. As Neil mentioned, a far greater proportion of businesses with a turnover of under \$50,000 registered than expected. The other issue is that a large chunk of the 700,000 to 800,000 below that threshold are non-profit organisations and sporting associations—those types of things—that have registered in terms of their input tax credits.

CHAIRMAN—Could you tell us about your review of your risk rating engine and what is happening?

Mr Russell—Yes, I can give a quick background on that. I have mentioned the international scanning preparation and the fact that we needed to put in place a very robust pre-issue checking mechanism. The number of returns and refunds is huge—9.7 million BASs are lodged in a year and there are around 2.4 million refunds. While there was a major compliance risk, there is an obligation on the tax office to support legitimate businesses. So the challenge for us is to make sure that we enable cash flow, particularly for small businesses, but do as much as we can to identify up-front the risk of claims. We responded in a couple of ways. Two complementary systems operate in terms of an automated check. The first is our registration information matching system. This came from intelligence that said: for people to claim a GST refund, they first need to be registered—so there needs to be a robust process around that. And we need to be very aware of businesses that registered in the lead-up to or just after the implementation of the GST. If they are not known to the tax office then there is a risk.

The RIMS, as we call it, operates at two levels. It has a reference list in which we can enter details of known personalities, businesses or their associates that have engaged in avoidance activities, and we can check new registrations against that reference list, which is continuously updated. At the second level of operation, we can compare each new activity statement registration with the population. What we are trying to do there is to identify things that look out of kilter—for instance, we might see a number of different business names or registrations that link to a common phone number or to a common address et cetera. That is not fatal in itself but it indicates that it is something we need to look at.

In tandem with that, we have what we call the risk rating engine, which is the automated check of all activity statements. It is focused principally on pre-issue cases, and what we seek to do there is to combine a risk assessment of the activity statement in terms of its history. So the system looks at data that we have on file for that particular registration and then combines that with a test of various thresholds that we have in the system. For instance, a very new registration with no taxpayer history behind it, claiming a refund of anything more than a trivial amount, would trigger an exception test. As to the way we respond to that, some of the tests are dedicated

fraud tests and, if the results throw up as very high risk, they are referred directly to our fraud intelligence area. The lower risk cases are sent to what we call our compliance verification centres, an outbound telephone control centre. We contact the taxpayer and ask for details of the claim—in some cases, we ask for copies of the documentation to be sent to us—and, if we are not satisfied with that, we make contact with third party suppliers to verify detail et cetera. There is a total process around that verification.

Mr SOMLYAY—Do most businesses use a tax agent to submit their returns?

Mr Russell—Most businesses use a tax agent, but the percentage is a lot lower in terms of preparation of business activity statements compared with income tax returns.

Ms Granger—It is almost 100 per cent for income taxable business. For individuals it is a little under 75 per cent. Activity statements are much less than that.

Mr SOMLYAY—Have you done a comparison of fraud cases between businesses using a tax agent to submit their BAS forms and those that do not?

Mr Russell—I cannot answer that.

Mr Barlow—I think we have done some sort of analysis—that is one of the risk factors that we might factor into a particular search. Some of the profiles that we have built up include not using a tax agent as one of the indicators of a higher risk, so we have done data mining on those sorts of variables.

Mr Higham—We have analysed and compared activity statements prepared by agents with those prepared by businesses themselves, and there is not a real, discernible difference in what generates fraudulent compliance issues.

CHAIRMAN—Have you had much experience in companies that originally applied for a BAS number, received it and decided to opt into the GST system—for instance, with people operating below the \$50,000 level at bed and breakfasts, and people who own commercial rental properties subsequently deciding to become input taxed?

Mr Russell—We have been conducting a refresh of the Australian Business Register, looking to ensure that we only have businesses registered that are required, and which choose, to be registered. We are not concerned with people who legitimately opt out of the system—in fact, we encourage that.

CHAIRMAN—Have you had much experience of that happening?

Mr Russell—Not as much as we would like. A lot of the people who are registered below the threshold continue to choose to be registered, even though we have put some effort into the education around that. There is a range of reasons, some psychological and some business oriented. Some of them feel that it is a badge of being a real business.

CHAIRMAN—I know that I found the cost of paying for taxation was greater than the GST recovered, so I was not worried about it. It is a whole lot cheaper to opt out and be input taxed.

Mr Higham—Across the whole market in the under \$50,000 category, overall they are net payers to the tax office. That group is not overall in a net GST refund situation. They are in a net debit situation with the tax office.

CHAIRMAN—Thank you very much. We would appreciate it if you would get back to us with any answers you promised, particularly if you can come up with a better definition of ‘fraud’.

Ms Granger—I promised to provide the Director of Public Prosecutions guidelines, and when that paper is ready you would like a copy of that?

CHAIRMAN—Yes, please.

Ms Granger—Okay. That will probably be available in December or the new year.

CHAIRMAN—Thank you for coming in, and thank you for your explanations and your cooperation. We do understand this is a difficult issue. If I seemed a bit aggressive in the beginning, it is because this is an ongoing issue that is, I understand, hard to solve; nonetheless, if we do not put pressure on you to help solve it, it never will be. That is what we are supposed to be here for.

Committee adjourned at 11.52 a.m.