

## Audit Report No. 19, 2002–2003

# **The Australian Taxation Office's Management of its Relationship with Tax Practitioners**

## **Introduction**

### **Background**

- 6.1 Tax practitioners assist taxpayers to deal with their taxation responsibilities and have become an integral part of the tax system. Although tax practitioners are a wide group of professionals working on taxation matters, the audit focused on the Australian Taxation Office's (ATO's) management of its relationships with tax agents. This was because tax agents form the core of the tax practitioner group and have a fundamental role in the effective operation of the tax system.
- 6.2 Despite the diversity in their activities and relationships with their clients, tax practitioners have an important role because they interpret the law, advise taxpayers and 'educate' taxpayers in tax law matters and in some

cases submit information to the ATO on behalf of their clients (i.e. taxpayer information).

6.3 The significance of tax practitioners in the operation of the tax system has increased markedly in recent decades because of:

- the rapid expansion of the scope and complexity of tax law, accompanied by shifts in reporting obligations on taxpayers flowing from the New Tax System;
- the growth in complexity of business operations in the economy;
- more involvement of individual taxpayers in investment activities and income sources other than personal exertion;
- increased use of the tax system to make social payments as well as to collect revenue; and
- the shift towards self-assessment as the guiding principle of tax administration.

6.4 The audit noted that the ATO had formally recognised that tax practitioners were critical to the efficient and effective operation of the tax system because:

- they streamlined the processes and linkages between the ATO and taxpayers; and
- they were able to influence their clients' behaviour, thereby providing a key means to secure taxpayer compliance.

6.5 Tax practitioners can also benefit from their participation as ATO–taxpayer intermediaries because:

- they could access the ATO's support services—priority services in some instances; and
- they could enter the regulated tax agent segment of the profession.

6.6 The audit also noted ATO's stated position that, as a priority, it invested in strategies to support the interaction of tax agents with the tax system. This was because tax agents perform significant processing functions and because they were critical for the ATO's education and communication efforts.<sup>1</sup>

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1 Auditor-General, *Audit Report No. 19, 2002–2003, The Australian Taxation Office's Management of its Relationship with Tax Practitioners*, Canberra, December 2002, pp. 11–13.

## The tax practitioner population

- 6.7 The number of tax practitioners is understood to be increasing in Australia. However, apart from tax agents—a group which is regulated, the ATO does not have comprehensive data on the total number or characteristics of the tax practitioner population. This is because the ATO is often unaware of the tax practitioner's interaction with taxpayers as it may not involve the ATO at all. However, these interactions (e.g. the tax advice the tax practitioner provides) may affect the ATO's administration of the tax system.
- 6.8 However, the ATO does have information on tax agents who form the largest component of the tax practitioner population. Approximately 25 000 tax agents were registered in 2001–02. Registration is undertaken under by independent statutory bodies, the Tax Agents' Boards (TABs), in each State.
- 6.9 The tax agent population has the following broad characteristics:
- each tax agent has, on average, 599 clients, but around half have fewer than 100 clients;
  - close to 50 per cent of practices are located in inner metropolitan areas; and
  - 80 per cent of the tax agent client base are individual taxpayers.
- 6.10 The use by taxpayers of registered tax agents has grown over time. In 1980, approximately 20 per cent of individual taxpayers sought professional assistance from tax agents to prepare income tax returns. By 2001, the proportion had risen to 76 per cent. The significance of tax agents' involvement in the tax system is shown by ATO processing statistics—in 2001–02, tax agents accounted for:
- 76 per cent of the 10.1 million individual returns;
  - 94 per cent of the 0.6 million company returns; and
  - 51 per cent of the 1.8 million quarterly Business Activity Statements (BASs).<sup>2</sup>

## The Australian Taxation Office's relationship with tax practitioners

- 6.11 In its dealings with tax practitioners, the ATO has to balance often divergent interests in an environment where issues are sometimes not
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2 Auditor-General, *Audit Report No. 19, 2002–2003*, pp. 13–14.

under the control of either party. Tax practitioners can also interact with many different areas of the ATO. The different legislated functions of the ATO determine a range of different types of interaction, including:

- client support—providing legislation, policy and system advice;
- service support—providing information, technical and procedural assistance;
- active compliance; and
- regulatory support.<sup>3</sup>

### Management structure and resourcing

6.12 All of the ATO's business and service lines interact from time to time with the various categories of tax practitioners. However, a unit has been established within ATO's Personal Tax business line to specifically manage and coordinate relationships with tax agents. The unit is titled the Tax Practitioner Group and Alliances Branch (TPG&A).

6.13 The ATO also consults and interacts with the other categories of tax practitioners as they are stakeholders who may represent or influence taxpayers. The major interactions are by way of:

- the ATO consultative bodies representing the personal tax, small business and large business sectors;
- key client manager relationships with large business participants in the financial advisory sector; and
- consultations with tax agents and professional associations with interest in GST issues.<sup>4</sup>

6.14 The ATO does not collect and attribute the costs of its management of relations with tax practitioners, or the tax agent segment, because costs are diffused throughout the ATO's business lines. However, for 2001–02 the TPG&A's direct costs were \$11.7million. As well, in 2001–02 the cost of the ATO Business Call Centre—the call centre most heavily used by tax practitioners—was \$56.4 million.<sup>5</sup>

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3 Auditor-General, *Audit Report No. 19, 2002–2003*, pp. 14–15.

4 Auditor-General, *Audit Report No. 19, 2002–2003*, p. 15.

5 Auditor-General, *Audit Report No. 19, 2002–2003*, p. 15.

## The audit

- 6.15 The audit focused on the various ATO–tax practitioners relationships which broadly matched the major functional areas of the TPG&A. Particular relationships reviewed were:
- ATO's regulatory relationship with tax agents;
  - the service support relationship with tax agents;
  - ATO's relationship with tax agents and members of the wider tax practitioner group in the professional bodies; and
  - ATO's call centre service support relevant to tax agents.
- 6.16 The audit took into account recent changes in the ATO's activities arising from an agreement between the ATO and the tax and accounting professional bodies in September 2002. The agreement was to improve ATO services with the initial priorities to include:
- the appointment of an ATO senior executive to coordinate support programs for tax agents, reporting directly to the Commissioner;
  - the development of 'client' relationship manager models;
  - improvement to on-line and telephone services; and
  - enhanced transparency of performance statistics and information relating to tax agents.<sup>6</sup>
- 6.17 The audit did not examine the ATO's provision of client support by way of ATO systems and legislation, or the compliance activities administered by areas of the ATO other than TPG&A.

## Audit findings

- 6.18 The audit acknowledged that ATO's management of its relationship with tax practitioners was a challenging task. Interactions were dynamic, multi-dimensional and necessarily involved ambiguity and the balancing of different interests. The relationship was also affected by factors, ranging from small, operational matters, to high-level strategic issues and matters outside the control of the parties themselves. A further complicating factor was that tax practitioners were a heterogeneous group.

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<sup>6</sup> Auditor-General, *Audit Report No. 19, 2002–2003*, p. 16.

- 6.19 The current relationship could generally be described as strained and tense. Consultations showed that the ATO and tax agents and some other tax practitioners perceived a considerable measure of dissatisfaction with the relationship. Further, on a range of measures, overall perceptions of the relationship had been negative, and increasingly so, in some areas. It was considered that the situation had arisen largely due to the pressures placed of tax reform on tax agents, other tax practitioners, and on the ATO's operational systems.
- 6.20 The ATO recognised that improvements were required particularly with in its relationship with tax agents. Initiatives aimed at better managing and enhancing the relationship have included:
- dedicated phone services and special complaint resolution services;
  - more extensive consultation processes with tax agents, and members of tax and accounting professional bodies; and
  - reactivation of consideration of reform in the regulation of tax agents.
- 6.21 The ANAO noted that useful mechanisms had been established to support tax agent relationship management, and this was accompanied by a renewed commitment from senior ATO staff.
- 6.22 To manage its complex relationship with tax agents, the ATO had established appropriate internal management, oversight and coordination mechanisms across its business lines. It also maintained a range of external liaison, consultation and communications systems that enabled two-way dialogue with representatives of tax agents and the tax and accounting professional bodies. While the ATO had substantial information about the characteristics of tax agents, its knowledge of characteristics highlighting possible risks of non-compliance was less comprehensive. Rectifying this knowledge gap was important because tax agents' fundamental importance to the tax system.
- 6.23 Although the ATO had a statement of principles on tax agent relationship management, there needed to be an integrated and consistent statement of its intended strategic relationship with tax agents which acknowledged the many dimensions of the ATO/tax agent relationship.
- 6.24 Regarding the wider tax practitioner group, the ATO's separate strategies were based on tax practitioner risk and influence in the tax system. A strategic framework for its relationship would be enhanced by the ATO ensuring its strategies specify the objectives of its interactions and how these objectives would be pursued.

- 6.25 The ATO had not developed performance information for the relationship management systems for tax agents and the members of tax and accounting professional bodies with which the ATO formally consulted. There also was no clear, comprehensive or consistent statement of the respective roles and responsibilities of itself and tax agents in the operation of the tax system.
- 6.26 The ATO was properly emphasising its tax agent compliance responsibilities in its regulatory relationship with tax agents. A differentiated service approach was being developed to secure taxpayer compliance through tax agents and other tax practitioners, such as the providers of BAS services. This was based on modelling performance characteristics of tax agents and tax practitioners in question, and using combined incentives and penalties. A range of education, information and call centre services had also been established over the years to assist tax agents fulfil their role.
- 6.27 However the lack of a consistent strategic framework for ATO's relationship with tax agents constrained the ATO's ability to maximise the benefits of its relationships from both an administrative efficiency and compliance viewpoint.
- 6.28 The National Review of Standards for the Tax Profession in 1994 noted the challenges and ideas for reform of the tax agent regulatory framework. However, the fundamental reform canvassed in that report has yet to occur. From July 2002, responsibility for the design of tax law and regulations, including for the review of standards for the tax profession, was passed from the ATO to the Treasury. The ATO no longer contributes to policy development and design but will continue to provide advice on administrative impacts. Resolving this longstanding matter of reforming the regulatory framework may assist the ATO's relationship with tax agents.<sup>7</sup>
- 6.29 The Auditor-General made ten recommendations to which the audited agencies agreed, or agreed in principle.<sup>8</sup>

## The Committee's review

- 6.30 Two agencies were invited to give evidence to the Committee at a public hearing on Wednesday, 30 April 2003. The agencies were:

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7 Auditor-General, *Audit Report No. 19, 2002–2003*, pp. 16–19.

8 Auditor-General, *Audit Report No. 19, 2002–2003*, pp. 30–3.

- the Australian National Audit Office; and
- the Australian Taxation Office.

6.31 The Committee took evidence on the following issues:

- tensions between the ATO and tax practitioners;
- the tax agent profile;
- tax agent competency;
- consultation processes with tax agents; and
- communication systems available to tax agents.

### **Tensions between the Australian Taxation Office and tax practitioners**

6.32 The ATO noted that Australia was unusual in there being a close relationship between the ATO and tax practitioners.<sup>9</sup> There would always be a tension in the relationship because the ATO was the law interpreter and the checker of compliance. The aim was to make the natural tension a positive and professional tension.<sup>10</sup>

6.33 However, the introduction of new tax system had caused additional pressures and the time of audit fieldwork 'was a very tense period'.<sup>11</sup>

6.34 The Committee acknowledges that the introduction of taxation reforms was a time of change and learning for both the ATO and tax practitioners. The Committee is pleased with the advice from the ATO that it monitors its relations with its stakeholders,<sup>12</sup> and with the advice that at the time of the public hearing the relationship with the Institute of Chartered Accountants of Australia had improved.<sup>13</sup>

### **Tax agent profile**

6.35 Evidence provided by the ATO indicated that tax agents play a pivotal role in the lodgement of income tax returns. Tax agents lodged about 98 per cent of business, and about 75 per cent of individual non-business, tax returns.<sup>14</sup>

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9 Mr Mark Konza, *Transcript*, 30 April 2003, p. 25.

10 Ms Jennifer Granger, *Transcript*, 30 April 2003, p. 26.

11 Ms Jennifer Granger, *Transcript*, 30 April 2003, pp. 25–6.

12 Ms Jennifer Granger, *Transcript*, 30 April 2003, p. 25.

13 Mr Steve Chapman, *Transcript*, 30 April 2003, p. 37.

14 Ms Jennifer Granger, *Transcript*, 30 April 2003, p. 36.



- 6.36 The ATO provided an update to the Committee of its response to the ANAO's recommendation which was in part 'to identify and analyse the characteristics of the tax agent population.'<sup>15</sup>
- 6.37 The ATO told the Committee that it was embarking on research with the professional associations entitled 'The World of the Tax Agent'. The research had provided information on:
- the demographics of tax agents;
  - indicators of tax agent business success; and
  - the factors which motivate and frustrate tax agents.
- 6.38 The average age of tax agents was reflective of the 'baby boomer' profile of Australia. This meant that over the next few years significant numbers of tax agents would be retiring and would need to be replaced. Unfortunately, research showed that younger graduates were not looking to public practices for their career. The ATO was working with the accounting profession to address this likely shortfall.<sup>16</sup>
- 6.39 The ATO told the Committee that indicators of tax agent business success concerned their business practices such as:
- how they structure the operations of their firm;
  - the strong correlation between the profitability of a practice and the success of the practice; and
  - the take-up and use of technology, with computerisation and online accessing of the ATO.<sup>17</sup>
- 6.40 The ATO's research indicated that broad compliance work was the main task of tax agents. Many obtained personal fulfilment from their role facilitating their client's success. The witness added:
- One of the frustrations they are seeing at the moment is that too much of their time is being spent on regulatory tort work when they would like to spend more time on business planning and giving business advice to their client. That suggests the need to improve the level of technology, streamline operations or even improve the levels of service we provide.<sup>18</sup>

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15 Auditor-General, *Audit Report No. 19, 2002–2003*, Recommendation 5, p. 79.

16 Mr Steve Chapman, *Transcript*, 30 April 2003, pp. 29–30.

17 Mr Steve Chapman, *Transcript*, 30 April 2003, p. 30.

18 Mr Steve Chapman, *Transcript*, 30 April 2003, p. 30.

- 6.41 The Committee believes that information on the tax agent population provides a valuable tool to the ATO. While the Committee notes ATO advice that the compliance profile of tax agents is part of future phases of the research,<sup>19</sup> this important aspect of profiling should not be overlooked.

### Tax agent competency

- 6.42 The Committee asked the ATO whether it had considered evaluating the quality of tax agent services through ATO staff posing as clients and seeking taxation advice.
- 6.43 The ATO responded that it did not engage in this form of consumer protection. The witness added that most tax agents belonged to a professional body and were bound by the code of conduct and ethical arrangements of those bodies. Another quality control mechanism was for tax agents considered to be deficient to be referred to the appropriate state taxation board.<sup>20</sup>
- 6.44 The ATO was unaware of state taxation boards undertaking covert assessment of tax agents. The boards would tend to 'get a good feel for how an agent is operating' from the number of complaints about a particular agent. However, the boards did not operate like a department of fair trading and an agent would 'have to stuff up pretty badly to really warrant any sort of stern action from a tax agents board.' Generally complaints from the public would be lodged with a state department of fair trading.<sup>21</sup>
- 6.45 In dealing with tax agent competency, the ATO told the Committee that it preferred an educative approach. If a tax agent was found to be systematically claiming incorrect amounts or applying the law incorrectly, the ATO would discuss the issue with the agent. In extreme cases it was open for the ATO to refer the issue to a taxation board.<sup>22</sup> Following the hearing the ATO advised the Committee in a supplementary submission that it had referred 33 cases to the state tax agents boards in the previous year.<sup>23</sup>
- 6.46 The ATO's submission also noted that tax agents were subject to a three years registration cycle with state taxation boards and that tax agents were

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19 Mr Steve Chapman, *Transcript*, 30 April 2003, p. 30.

20 Mr Steve Chapman, *Transcript*, 30 April 2003, pp. 33–4.

21 Mr Mark Konza, *Transcript*, 30 April 2003, p. 34.

22 Mr Steve Chapman, *Transcript*, 30 April 2003, p. 34.

23 ATO, *Submission No. 19*, p. 3.

sometimes deregistered. For example in the financial year 2002–03, tax agents boards had:

- received 563 written complaints;
- cancelled 86 registrations;
- written to 199 tax agents asking them to show cause;
- referred 94 tax agents to the Tax Office for investigation; and
- suspended 5 tax agents.<sup>24</sup>

6.47 Regarding the promoters of taxation schemes, the Committee was advised the ATO had a promoters task force. The aim of the task force was to identify at an early stage taxation arrangements which raised ATO concern. The ATO was prepared to issue alerts to advise tax agents of its concern about particular schemes and that it was investigating particular promoters.<sup>25</sup>

### Consultation processes with tax agents

6.48 The Committee drew attention to the demands placed on tax agents when they contributed to ATO consultative committees and raised the issue of whether they should be remunerated for their efforts.

6.49 The ATO responded that when it talked to tax agents it always asked them if they wished to become a member of one of the consultative committees. Tax agents were never pressured to contribute and the ATO was 'very conscious of getting a wide range and a base so that we get a representative sample of agents.'<sup>26</sup>

6.50 The ATO added that recently it had worked with particular tax agents to allow them to contribute at a level which was more manageable for them. This involved finding more representative agents and working with agents to 'bring forward people in their networks, people they [could] trust as good representatives.'<sup>27</sup>

6.51 The ATO told the Committee that it considered remuneration when it was accessing particular expertise, but:

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24 ATO, *Submission No. 19*, p. 1.

25 Ms Jennifer Granger, *Transcript*, 30 April 2003, p. 35.

26 Mr David Diment, *Transcript*, 30 April 2003, p. 32.

27 Mr Mark Konza, *Transcript*, 30 April 2003, p. 33.

... where we are consulting more because of an agent's ability to represent their client's experience and represent the experiences of their peers and so forth, we do not generally remunerate ...<sup>28</sup>

- 6.52 The Committee does not consider it appropriate for the ATO to remunerate tax agents who are members of consultative committees. Membership of a consultative committee brings benefits other than financial, such as credibility with peers, and first hand knowledge of ATO position on issues and initiatives. Moreover, for remuneration to be more than token, it would have to be reasonable—such a level of remuneration could distort the sample of tax agents serving on consultative committees and make it unrepresentative.

## Communication systems available to tax agents

### Telephone systems

- 6.53 The ATO advised the Committee that a free call 1300 telephone number was now available to callers requiring information on tax matters. The system allowed calls to be redirected to the relevant ATO officer, even to mobile phone numbers, without incurring a charge to the caller.<sup>29</sup>
- 6.54 Further, a survey had indicated that improvements in the telephone system had made available to accountants the equivalent of an additional four hours a week for other work.<sup>30</sup> The ATO was able to analyse the 60–65 thousand calls it received each week and had discovered that some tax agents made multiple calls. This was often because they did not know where they could access the information themselves.<sup>31</sup>
- 6.55 Identification of such problems had led to the development of the ATO's internet tax agent portal.

### Tax agent portal

- 6.56 The ATO's tax agent portal is designed to enable tax agents to obtain information concerning their clients, including:
- client lists of those who had or had not lodged a return;
  - real time on-line access to their client's accounts to view debts, their make up and transaction history;

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28 Mr Mark Konza, *Transcript*, 30 April 2003, p. 33.

29 Mr Steve Chapman, *Transcript*, 30 April 2003, p. 27.

30 Mr Steve Chapman, *Transcript*, 30 April 2003, p. 30.

31 Ms Jennifer Granger, *Transcript*, 30 April 2003, p. 31.

- a secure message service unlike the normal email service;
- the ability in the future to request funds or the transfer of funds between particular accounts; and
- the ability to update addresses on the ATO's business register.<sup>32</sup>

6.57 The ATO advised that the current security was at the SSL level 128-bit security with a password and a personal identification number. It was hoped to move towards the use of the public-private key infrastructure.<sup>33</sup>

#### Committee comment

- 6.58 The Committee endorses the ATO's endeavour to improve its communication with tax agents. The Committee expects that the ATO tax agent portal to be continually reviewed to take advantage of advances in information technology.
- 6.59 Notwithstanding the improvements to the ATO's communication with tax agents, the Committee is concerned with the cost of compliance with the taxation system.

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32 Mr Steve Chapman, *Transcript*, 30 April 2003, p. 32.

33 Mr Steve Chapman, *Transcript*, 30 April 2003, p. 32.

