Joint Committee of Public Accounts and Audit

ANSWERS TO QUESTIONS ON NOTICE

Australian Taxation Office

Bi-annual Hearing – 21 September 2007

Question	1
Topic:	The size and revenue estimate of Phoenix Practices
Hansard Page:	PA 9-11

Senator Hogg asked:
Given that you have identified the problem, firstly, how many businesses would you say fall into that category and, secondly, how much money is at stake for the recipients?
Mr Konza: A great many micro businesses go broke every year. That is the nature of commerce, so it is very difficult for an observer like us to pick which ones were, as the Commissioner said, ridden into the ground and which ones failed through normal commercial endeavour. We tend to pick up on what we call the serial phoenixes—they are the ones you are able to pick up most readily—
Senator Hogg: That is what I am referring to. You must have some idea of the size of the problem in terms of the number of businesses—is it five, is it 10, is it 1,000, is it 10,000—and the quantum of money that is at risk; otherwise it then boils down to whether there is going to be a desire on the part of the ATO to pursue that because it might not be a cost-effective, efficient operation to do so.
Mr Konza: We do not estimate how many businesses are doing this or what the total size of it is. Our job is to collect taxation rather than try and run the commercial system.
Chair: I understand that, Mr Konza, but if you cannot foreshadow what it is and what the figure may be, can you give us an idea of what it has been, say, in the last financial year: how many businesses were involved in these sorts of operations; what amount of dollars are we talking about? That might give us an indication of what might still be out there.
Ms Granger: What we could do, which might give you some insight, is tell you what activities we have done with what results and what industries—we could do you a summary; we do not have that here today but that would give some insight into—
Senator Hogg: I thought you might have to take this on notice, but it seems to me it is critical to the whole thing. It seems to me that it is a real problem. It seems to me that it is something that needs addressing—and you have identified that yourself. I am just surprised that you do not know the implications in terms of the number of businesses. I think the chair raised the important issue—

Australian Taxation Office response:

The Tax Office does not have an estimate of the number of businesses involved in phoenix activities nor the money at risk for superannuation recipients.

Since 1997, the Tax Office has targeted the worst Phoenix offenders via a coordinated program of audits, prosecutions and debt collection activity. Intelligence provided by Debt areas of the Tax Office and by key externals including insolvency practitioners, is crucial to supporting our risk assessment and case selection processes. The major

focus of the Tax Office has been on serial offenders who use deliberate and fraudulent methods to avoid their taxation obligations. 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 $76m was in respect to tax and $16.1m was in respect to penalties and interest.

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 $7m 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 $1.6m in PAYE monies. His home detention "conditions" actually permitted him to continue to visit his work premises on a daily basis.

Most large scale Phoenix activity occurs in businesses that have income turnovers in the $2-15m range. The risk industries continue to include building and construction; labour hire; employment agencies; property developers; road transport and the security industry.

Whilst the main issue is non remittance of Pay As You Go Withholding (PAYGW), manipulation of goods and services tax input tax credits and non-compliance with superannuation obligations is also of significant concern.

A recent Tax Office-wide internal review identified wealth creation and competitive advantage as the main drivers of Phoenix behaviour. As a consequence of the review, the Tax Office focus has shifted to removing those drivers through strategies such as:

- Improved work processes, system enhancements and increased collaboration across the Tax Office, which has improved awareness of the Phoenix risk and increased our capability to more effectively and efficiently address Phoenix related matters, including Phoenix debt. This has enhanced our ability to more readily identify Phoenix activity and facilitated earlier intervention. As a result those now being identified as new and emerging Phoenix operators are being targeted by Tax Office Phoenix Teams, not just serial recidivists. These combined activities will also lead to a reduction in Phoenix-related debt, as we are targeting these arrangements earlier, more efficiently and more effectively than ever before.

- Working with external bodies, especially the Australian Securities and Investments Commission (ASIC), the Insolvency Practitioners Association of Australia and representatives of the Building and Construction Industry. Information Intelligence exchanged with ASIC is now leading to an increase in the number of company directors who are being disqualified by ASIC for their participation in Phoenix and related activities. ASIC is following up these disqualifications with media releases, which helps ensure that the public is alerted to the behaviour of the disqualified persons. This assists in removing the competitive advantage these persons may previously have had, as other businesses are being alerted to their non-compliance and would be reluctant to engage them in business. By reducing the business activity of the Phoenix operator there will

be a direct impact on that person's ability to create "wealth", both business and private.

- Identifying a number of legislative proposals which are designed to offer greater deterrence to Phoenix behaviour.

Our broad objective is to focus on prevention rather than treatment of the risk.

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Question	**2**
Topic:	**Electronic data matching**
Hansard Page:	**PA 12-13**

Senator Murray asked:

My second general question arising from your statement, Commissioner, relates to new strategies to tackle tax evasion. I think it is poorly understood in this country what contribution integrity measures, advanced computer technology and better analytical and profiling systems have made to a more efficient collection of tax—and the consequence we can see, of course, is in very strong revenues. The data-mining capacity through linkages between computer datasets and having the programs that can do that have contributed enormously to focusing and targeting and making sure that you are covering the field. But there is one area, a massive area, which is outside your remit, where huge transactions are undertaken and where I suspect a great deal of tax evasion lies and has not been addressed—that is, the state registry systems for property and other fixed asset transactions. I know you can access them manually, but there is no computer linkage ability for data mining. What efforts is the commissioner undertaking to try and encourage states to make those registries open and available to the tax office? Do you consider that to be a government-to-government problem rather than a tax office problem?

Mr D'Ascenzo—We try to create good relationships with state registries. We do access that information as part of our inquiries but, as you point out, it does depend on how automated processes are in terms of our efficiencies. I am not sure that the tax office can do any more than indicate to the respective parties our interest in that information. I do think it is possibly a government-to-government issue. I would like to also highlight and reinforce your comment, Senator, about the importance of data mining and data matching. Last year, we tried to match or use something like 200 million pieces of information; 50 million of which we were able to have an appropriate matching process. So you can see that, in terms of the use of technology to match data and to use data mining exercises, we are fairly much at the forefront. Indeed, last year we won a national award in relation to our efforts on data mining and analytics.

Ms Granger—I would add that we are in fact electronically data matching property information with state registries.

Senator MURRAY—All, or some?

Ms Granger—*I think we have just about got the lot now. I will confirm that for you.* It is true that this has been a developing exercise—you have been asking those questions for a while—but I can tell you that seven million property transactions have been matched to over 30 million tax returns since 2004. What is in its infancy is share transactions. That is the one we are working through now. One of the ways, with the

cooperation of states, that we have been able to improve this is where we need data to be modified for our purposes. If we require that, we will fund that, so that helps improve it, but we now have protocols with all states and territories. *I do believe we are matching all, but I will confirm that precisely for you.*

Australian Taxation Office response:

The Tax Office commenced its large scale collection of property title transfer data in late 2004. The primary business driver for this exercise was to address, through data matching processes, risks in relation to capital gains tax reporting and revenue collections. It was recognised early in the process that the value of this data has much wider implications for a number of compliance areas across the Tax Office. This data is now being used by a number of Tax Office compliance areas for other purposes, including projects centred on high wealth income individuals and other risk areas involving the disposal of assets.

Information from all relevant state and territory authorities[1] is being provided to the Tax Office on an ongoing basis. However, in respect of Western Australia, the Tax Office is currently negotiating with the Western Australian Land Information Authority to augment the data being supplied by the State Revenue Office.

Data is being provided for all transactions from 1 July 1999. In certain circumstances, data is also being sourced from as early as 1985, the year that capital gains tax legislation was first introduced.

The intention to undertake a long term data matching program, using this accumulated data, was first advertised to the wider community on 31 May 2005 *(Commonwealth of Australia, Special Gazette No. S 90).* The program was again advertised on 20 September 2006 *(Commonwealth of Australia Gazette No. GN 37).* As with all major data matching programs where personal information about individuals is used, data matching program protocol documents are submitted to the Office of the Privacy Commissioner for comment, prior to the commencement of each program.

[1] New South Wales Office of State Revenue, New South Wales Department of Lands, Victorian State Revenue Office, Australian Capital Territory Planning and Land Authority, Australian Capital Territory Registrar General – Land Titles Office, Northern Territory Treasury, Northern Territory Department of Planning and Infrastructure, Northern Territory Registrar General - Land Titles Office, Queensland Office of State Revenue, Queensland Department of Natural Resources Mines and Water, Tasmania State Revenue Office, Tasmania Department of Primary Industries and Water, South Australia revenue Office, South Australia Land Services Group, Western Australia Office of State Revenue

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Bi-annual Hearing – 21 September 2007

Question	**3**
Topic:	**Proposed booklet: 'Role and responsibilities of the Tax Office'**
Hansard Page:	**PA 20**

Senator Watson asked:

Does it include the issue that I referred to earlier where, if a taxpayer wishes to claim a tax deduction and they are self-employed, they must advise the tax office in advance of that intention? Otherwise people can lose tax deductibility simply through lack of knowledge of the changed law. That would worry me.

Ms Vivian—*On that one, I will check.* I am not sure whether it is directly in the booklet, but one of the things precisely on that issue is that we are looking—particularly tied up with the Better Super changes—to try to make that a bit clearer in the return form stationery that you talked about, along with working with the funds in how they pass that information out to the members.

Australian Taxation Office response:

This matter is addressed in the 2007 Tax Pack Supplement at Question D13 in the Deductions, tax offsets, adjustments and credits section. This provides the details for self employed people to claim a deduction for superannuation payments. It also points out that they must advise their superannuation fund trustee of their intention prior to submitting their tax return, or by the end of the financial year following the year in which the contribution is made, whichever is the earlier. The superannuation fund is required to acknowledge receipt of the notice. Taxpayers do not have to provide prior advice to the Tax Office. The requirement is at section 290.170 of the *Income Tax Assessment Act 1997*.

However, it is recognised that taxpayers should be aware of this requirement, to inform their superannuation fund, sooner than when preparing their tax return, and the Tax Office is currently studying improved communication possibilities.

The Tax Office will release a new publication *How your self managed super fund is regulated*, in the near future. This publication, under the working title 'Role and responsibilities of the Tax Office', was mentioned by the then Deputy Commissioner Superannuation, Raelene Vivian, at the hearing of the Joint Committee of Public Accounts and Audit on 21 September 2007.

This publication is not intended to address specific income tax matters relating to superannuation. It is designed to provide an overview of the regulatory environment in which self managed super funds operate. It outlines the role and responsibilities of

the Tax Office and also mentions the roles of the two other superannuation industry regulators, the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC). The publication also addresses a recommendation from the Australian National Audit Office's (ANAO) report *The Tax Office's Approach to Regulating and Registering Self Managed Superannuation Funds.*

The publication also outlines the roles of industry professionals who provide advice and assistance to self managed superannuation funds. This publication and others dealing with self managed superannuation funds and other areas of superannuation are available on the Tax Office website.

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Australian Taxation Office

Bi-annual Hearing – 21 September 2007

Question **4**

Topic: **Tax Havens – Malta**

Hansard Page: **PA 22**

Ms Grierson asked:

I am pleased to see some data matching being done by ATO at the wealthier scales rather than at Centrelink customers singularly; I am pleased to hear that. Another area you identified ATO compliance as a headline issue is offshore movement of funds and tax havens. I draw your attention to a series of articles recently in the *Australian* newspaper regarding the activities of the Commonwealth Bank of Australia in Malta. I gather those activities show that profits surged in the 2005-06 financial year from $865,000 to $31.4 million and that the tax bill for that return was in the order of a 7.3 per cent tax rate or $2.3 million. **Firstly, Commissioner, is Malta recognised as a tax haven by the ATO and the OECD?**

Mr D'Ascenzo—I am not quite sure whether it was. They recently reviewed the tax haven status of a range of countries and jurisdictions who have agreed to fall into a greater level of disclosure under the OECD principles. I am not quite sure where Malta falls there.

Mr Quigley—To my knowledge, I do not think Malta has—*we will check that and take it on notice.*

Australian Taxation Office response:

Malta is currently listed as a Tax Haven in the ATO's publication *Tax havens and tax administration* (at page 8) available on our website www.ato.gov.au but we are in the process of reviewing its status. Malta has very recently made amendments to its legislation so that it will meet the OECD's standards on transparency and effective exchange of information. Previously Malta would only provide information from banks and other financial institutions where the request involved tax fraud. Malta recently introduced amendments to their Tax Act that allows the Maltese officials to gain access, on behalf of a treaty partner, to bank information in all tax matters and not just those involving "tax fraud". The amendments came into force on 18th January, 2008 but do not provide for retrospective effect.

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ANSWERS TO QUESTIONS ON NOTICE

Australian Taxation Office

Bi annual Hearing – 21 September 2007

Question	**5**
Topic:	**Tax Havens – Malta; offshore banking facilities**
Hansard Page:	**PA 23**

Ms Grierson asked:
It is my understanding that the OECD does list it (Malta) as a tax haven. Secondly, I note some statements by the CBA that say they have an excellent and open relationship with the ATO. So I would ask: what advice has the ATO given to the Commonwealth Bank of Australia in its operations in Malta regarding the acceptability or otherwise of its business activities?
Mr D'Ascenzo—We would prefer not to comment on that because of the direct nature of information provided to a specific taxpayer.
Ms Grierson: Could I ask then for a brief generally on the tax regime that would apply and your approach to those sorts of activities in Malta? I would like to know as a taxpayer myself whether they have avoided tax and, if so, to what level? Would you know if they have been avoiding tax? What calculation would you put on that?
Mr D'Ascenzo: *We are happy to provide our strategies in relation to companies and financial institutions as a generic comment of what our strategies are in that area, but when I start to target a specific taxpayer in terms of information it gets close to what the chair said we need not do.*
Ms Grierson: If it was widened to other banks, and other banks are commenting that they are watching this closely in that they may consider doing the same, I would think you should make some public statements about that.
Ms Granger: We have actually – and we can give you a more detailed brief – made public statements about working with banks in relation to offshore banking facilities. We are doing a small pilot right now around Vanuatu. That is our first step in seeing, with cooperation, whether we can take a position.

Australian Taxation Office response:

When large business transact offshore, our general strategy is to review them for transfer pricing and compliance with Australia's controlled foreign company regime. As to whether there would be a transfer pricing risk in any given situation the ATO would need to weigh up the commerciality of the transaction with any tax benefits obtained. The ATO has a robust and detailed risk assessment approach through the Client Risk Reviews and Transfer Pricing Record Reviews that we undertake. These activities are articulated in the *Large Business and Tax Compliance* publication available on our website at www.ato.gov.au.

Australian banks operating through subsidiaries in Malta will be taxed on overseas profits if those profits do not constitute what is termed "active income". Generally

those profits derived from the conduct of banking activities will constitute active income and will not be taxed under Australian income tax law.

The ATO has worked on a cooperative project with some Australian financial institutions and in a pilot program have asked some of their overseas subsidiaries or branches in Vanuatu to write to their Australian customers informing them of how to make, if required, a voluntary disclosure of any undisclosed offshore income under the ATO's Offshore Voluntary Disclosure Initiative (OVDI). Up to 19 April 2008, $28,400,922 in omitted income from 661 taxpayers has been disclosed under the OVDI. This includes $3,046,960 from taxpayers who have lodged 45 outstanding tax returns.

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Australian Taxation Office

Bi-annual Hearing – 21 September 2007

Question **6**

Topic: **Taxation Ruling TR 2006/14**

Hansard Page: **PA 30**

Senator Watson asked:

My first question is on taxation ruling 2006/14, which concerns capital gains tax and life interest. I understand it is a contentious one. Is it before the courts and what are the issues before the courts?

Australian Taxation Office response:

To date, no issues regarding Taxation Ruling TR 2006/14 have been referred to the Administrative Appeals Tribunal (AAT) or the courts.

A recent AAT decision decided that an amount received by a life tenant to compensate the tenant for a breach of trust by the trustees in relation to the trust's investment policy was assessable as ordinary income. The issue of capital gains tax did not arise. The taxpayer has appealed the decision to the Federal Court. Were the court to find that the amount was not ordinary income, then the capital gains tax implications of the compensation would need to be considered.

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Australian Taxation Office

Bi-annual Hearing – 21 September 2007

Question **7**

Topic: **ATO booklet: *Business and Professional Items 2006***

Hansard Page: **PA 30**

Senator Watson asked:

This question relates to page 21 of the ATO booklet '*Business and Professional Items 2006'*. Under the heading 'Contractor, sub-contractor and commission expenses', you include agency fees. The booklet states that under agency fees must be included the heading 'Advertising'. As an accountant, I cannot see how advertising is an agency fee. If you put that under sub-contractors, why not insurance, which is usually put under the heading of other business running expenses?

Australian Taxation Office response:

The Tax Office acknowledges that the word 'advertising' could be misleading or confusing for taxpayers in the above context. The word was meant to convey that fees paid for the services of an agency, such as an advertising agency, should be shown at the label.

The Tax Office thanks Senator Watson for his feedback and plans to change the words to, *"Agency fees - for example, for services provided by an advertising agency"* in the 2008 edition of the publication to make the meaning clear for taxpayers.

Advertising may be treated as either an agency fee or a direct expense depending on the circumstances. The instructions on page 30 of *Business and professional items 2007* provide for advertising to be included under "All other expenses" and states that:

"Other expenses include wages, accounting and professional fees, advertising, office supplies, foreign exchange (forex) losses and any loss on the sale of a depreciating asset as shown in your accounts."

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Australian Taxation Office

Bi-annual Hearing – 21 September 2007

Question	**8**
Topic:	**International accounting standards**
Hansard Page:	**PA 30**

Senator Watson:

Under international accounting standards one of the options given to companies is to determine their income on a 'fair value' basis. What are the tax and compliance implications of that? On a simple examination, I would have thought that you would probably have to keep two separate sets of books, one for determining your tax office obligations and one for the fair value. This would add enormously to your compliance costs.

Australian Taxation Office response:

International accounting standards have been adopted in Australia since 1 January 2005 under the banner of the Australian Equivalent International Financial Reporting Standards (AIFRS). Only entities that are reporting entities under the *Corporations Act 2001* or otherwise producing a general purpose financial report must apply AIFRS to their financial reports. Consequently there are a significant number of companies that are not required to comply with AIFRS.

Accounting uses a number of measurement methodologies to determine income, expense, assets or liabilities. One measurement methodology more widely utilised with the introduction of AIFRS is 'fair value'. Within AIFRS use of fair value is sometimes mandated or may be available by choice. Other measurement methodologies are also utilised in AIFRS, a prevalent example being historical cost.

'Fair value' is defined in AIFRS as 'the amount which an asset could be exchanged, or a liability settled, between knowledgeable willing parties in an arm's length transaction.' Examples of the use of fair value measurement are the methodology applied to initially account for business combinations, revaluation of non-current assets and the valuation of certain financial instruments, which are either assets or liabilities in the balance sheet.

The impact of 'fair value' accounting on business reflects another example of differences in accounting concepts and tax laws which taxpayers have historically had to accommodate in their business systems. It is not so much about needing two 'sets of books' as having to integrate accounting and tax systems to deal with the essential differences.

How sophisticated and how integrated the tax and accounting systems used in a business has always varied significantly between different business taxpayers. Commonly an entity will determine its accounting profit (which may include fair value measurements) and then calculate their taxable income by making adjustments as additions, or subtractions, from the accounting profit. In this process separate databases and system information will often be utilised.

The introduction of AIFRS will have caused some adjustment in the existing systems and processes for both ascertaining accounting profit and taxable income. Only a part of that adjustment would be a direct result of the expansion in the use of fair value measurement in AIFRS. The requirement to change tax and accounting systems for AIFRS would cause additional compliance cost to rebuild particular systems or process. However, once built, significant additional compliance cost in the ongoing use of the changed systems is less likely to occur.

It is noted that recent legislative developments in taxation law have deliberately looked to accounting methodologies and use of financial statements to provide a basis of measurement to support or achieve particular tax policy outcomes. Examples of this are as part of the thin capitalisation regime, as part of the allocable cost amount and tax cost setting process in the consolidation regime and the current proposals to tax financial arrangements. One of the primary reasons for this approach in the legislation is to lower compliance costs.

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ANSWERS TO QUESTIONS ON NOTICE

Australian Taxation Office

Bi-annual Hearing – 21 September 2007

Question	**9**
Topic:	**Asset and tax liability implications of climate change policies**
Hansard Page:	**PA 30-31**

The Chair asked:

I have a question about the burden of the obligations that are now placed on a lot of tax agents across portfolio areas. **Also, with all of the discussion about greenhouse gases, climate change and an emissions trading scheme, have you started work on the asset and tax liability implications to corporations and taxpayers?** We will send you a few questions on notice about that.

Mr D'Ascenzo: *We will try to get back to you as soon as we can.*

Australian Taxation Office response:

Trading under the Australian emissions trading scheme is due to commence in 2010.

A project team has been established within the Tax Office to prepare for the introduction of the emissions trading scheme.

The Tax Office has been working closely with Treasury to identify and resolve the range of tax technical issues that may be associated with the scheme.

The Tax Office has also been closely monitoring business discussion and preparations for the introduction of the emissions trading scheme.

The above activity will ensure the Tax Office is in a good position to provide any necessary advice to the community on the tax consequences of the emissions trading scheme after passage of the appropriate legislation.

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ANSWERS TO QUESTIONS ON NOTICE

Australian Taxation Office

Bi annual Hearing – 21 September 2007

Question	**10**
Topic:	**Tax Agents**
Hansard Page:	**Written Question on Notice received on 27 September 2007.**

The Committee would like to develop an understanding of what proportion of tax agents' work is traditionally tax related and what proportion involves other portfolio areas:

a) Could you please summarise the roles of tax agents that involve taxing economic activity, and those roles that relate to other aspects of Government finance, such as Family Tax Benefits and the previous version of the Child Care Tax Rebate?
b) Do you have any data, estimates or feedback from tax agents on the proportion of time they spend on these two areas?
c) Do you have any data, estimates, or feedback from tax agents on how they view the work involved in these two areas?

Australian Taxation Office response:

a) Our research indicates at a broad level that tax agents currently spend, on average, 75% of their time on tax related work including income tax and GST. The remainder is spent on non tax related work such as providing business and financial advice to their clients. The actual break-up between tax related work and non tax related work will be influenced by the type of business and client base of each individual agents' practice. The more significant the number of business clients, it would be expected that a more significant proportion of time would be spent on matters such as business and financial advice.

   Our assumption is that time spent on Family Tax Benefit and Child Care Tax Rebate and associated tax/welfare interface activity is included in the tax related work. The proportion of time spent on Family Tax Benefit, Child Care Tax Rebate and associated tax/welfare interface activity will be higher for those tax agents whose client base is focussed on salary and wage earners.

   Many tax agents complete Family Tax Benefit claim forms on behalf of their clients. This would usually be done at the same time as the income tax return preparation. The two documents would be lodged together.

   In terms of the previous version of the Child Care Tax Rebate, agents could confirm their client's child care data and eligibility for the rebate prior to completing the income tax return. This data was available on the Tax Office website.

b) No. However, data as at 31 December 2007 showed that of the 137,612 claims for Family Tax Benefit lodged with the Tax Office for the period 1 July 2005 – 30 June 2006, 115,590, or nearly 84%, were lodged by tax agents. The data also shows that approximately 8.5m individual income tax returns for the same period were lodged by tax agents. Note that the number of claims lodged with the Tax office only represents a small percentage of total claims for FTB (approximately 6%).

c) We have no formal data on this topic.