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Australian Taxation Office

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By: Mr Michael D'Ascenzo - ATO

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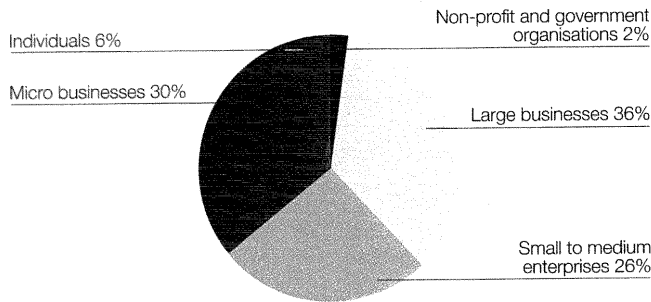
2006-07
Compliance Program

SUMMARY OF COMPLIANCE RESULTS 2005-06

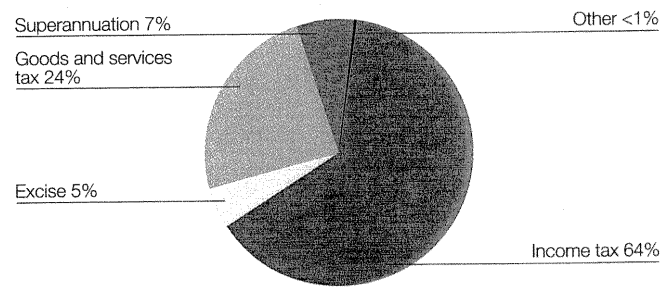
Our *Compliance program 2005-06* identified the activities we had planned to maximise community compliance with tax and superannuation laws and deter non-compliance.

The results for 2005-06 in this publication are based on preliminary data and are indicative only. Final results for 2005-06 are published in our *Annual report 2005-06*, due for release in October.

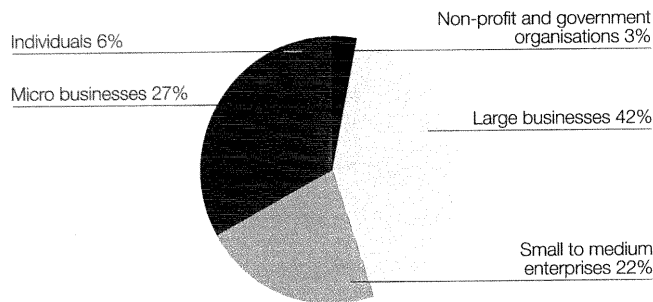
Preliminary liabilities¹ 2005-06 by market segment^{2,3}



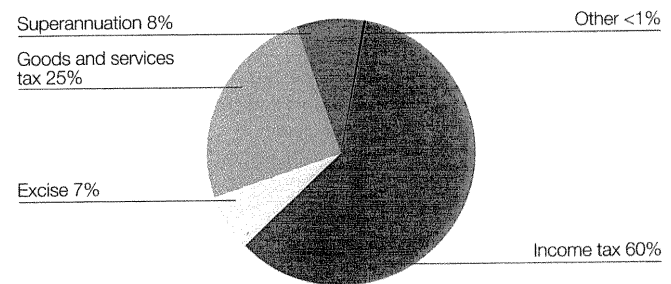
Preliminary liabilities¹ 2005-06 by product^{2,3}



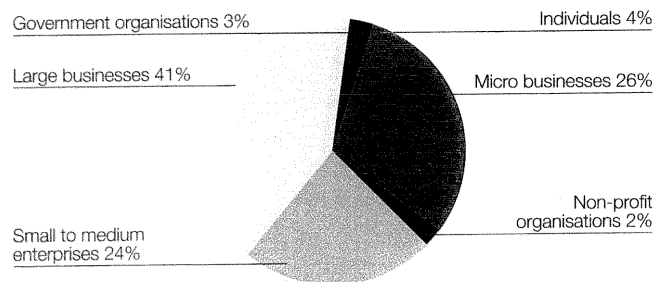
Preliminary estimated collections⁴ 2005-06 by market segment^{2,3}



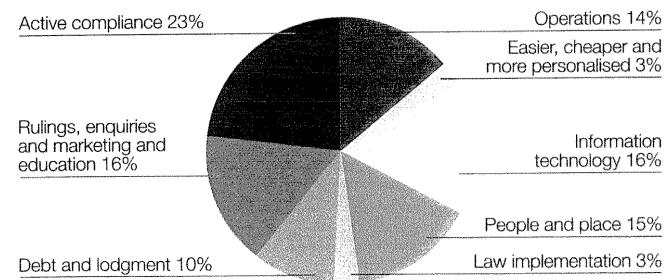
Preliminary estimated collections⁴ 2005-06 by product^{2,3}



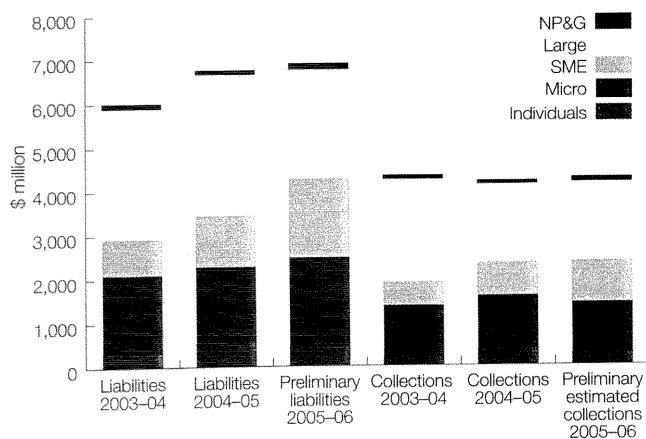
Debt collection 2005-06³



Preliminary Tax Office expenditure 2005-06



Our total performance 2003-04 to 2005-06^{1,2,3,4,5,6,7,8}



- 1 Preliminary liabilities are the net value of debit and credit amendments from active compliance intervention on returns, statements and claims. The impact is a combination of tax, penalties, interest and transfer payments and covers excise, goods and services tax, income tax and superannuation products.
- 2 Results include activities undertaken to prevent the issue of incorrect refunds or payments. For 2006-07, we are examining how we may separate pre-issue active compliance activities.
- 3 Lodgment enforcement was previously reported as an element of our debt collection activities. Commencing 2005-06, these key compliance activities are reported as part of liabilities and collections.
- 4 Estimated collections are a combination of actual monies collected from large business income tax and serious evasion and fraud cases, including some related to prior year assessments, and an estimate of the value of collections to be raised in relation to the remaining liabilities, based on a sample of liabilities raised in 2004-05.
- 5 The 2003-04 and 2004-05 figures are taken from our *Annual report 2004-05*.
- 6 Preliminary estimate of credit amendments arising from the resolution of disputes in 2005-06 in the large market is approximately \$596 million. These amendments generally relate to liabilities raised prior to 2005-06.
- 7 Of reported liabilities for 2005-06, the preliminary estimate indicates that \$1.3 billion is in dispute from the large market results. Of this, approximately \$1 billion is subject to objection and \$0.3 billion is subject to appeal/litigation.
- 8 Included in the revenue results is around \$234 million that relates to pre-issue action required to adjust excise claim forms that were incorrectly completed by taxpayers. These cases required contact with the taxpayer to ascertain the correct information. We are reviewing the classification of this type of verification action in 2006-07.



Australia is underpinned by a myriad of government funded goods and services. The revenue system is an important instrument of social and economic policy. It is a vital ingredient in Australia's wellbeing.

The shape of the revenue system is a matter for government. The Tax Office's responsibility is to administer the tax law in a way that instils community confidence and encourages high levels of voluntary compliance. We also bring the government's attention to areas where the law is not operating in accordance with the policy intent or producing significant compliance costs. We hope to create an environment which allows the revenue system to achieve its objectives.

Our commitment to the community is to administer the revenue system fairly, in accordance with the law. We do this by helping taxpayers and their agents to understand their rights and responsibilities; by making it as easy as possible for them to comply; and by supporting those who want to comply by ensuring that there are real and tangible risks for those who don't – this is all about fairness for taxpayers and a level playing field for business.

Australia's revenue system generally relies on taxpayers self-assessing their tax liabilities under the law and paying the correct amount of tax. Fortunately we have a culture where the majority of Australians do the right thing and voluntarily comply with their tax obligations. So a key approach for us is to differentiate between taxpayers who are trying to comply, and those who are not. This perspective underlies the taxpayers' charter and our compliance model, which require us to understand taxpayers' circumstances, behaviours and risk profiles to develop appropriate and proportionate responses. Increasingly we are working with representative bodies to help us co-design those responses.

Having said that, we are not able to chase down every dollar of revenue nor are we able to satisfy everyone's wish-list; we are simply not resourced to do that. We have to make informed choices in the management of the revenue system and to direct our attention and effort (both help and active compliance) to the areas that are likely to have the biggest impact on levels of voluntary compliance. We have to do this while still maintaining a presence (both help and active compliance) across all the different market segments

to ensure continued community confidence. These are not easy decisions. That is why we make our compliance program public and seek input from the community on our priorities and the risks to its revenue system.

This year's compliance program describes the current and emerging risks we perceive to the effective operation of the revenue system, and how we propose to use our resources. We are open and accountable about our strategies, which reflect an appropriate mix of help, support, deterrence and enforcement, in order to encourage high levels of voluntary compliance.

The publication of our compliance program is also an invitation to the community to provide feedback to us on the risk management choices we have made. I encourage and look forward to a heightened level of engagement by the community and representative bodies in the care and management of Australia's revenue system.

Michael D'Ascenzo
Michael D'Ascenzo
Commissioner of Taxation

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Introduction

No tax administration is resourced to chase after every last dollar of tax, so the art of good tax administration is to create an environment which supports high levels of voluntary compliance. This is achieved in part by managing the inherent risks in the system by focusing on those areas that pose the highest risks in terms of non-compliance with the tax law.

Our compliance program describes the tax compliance risks we are most concerned about and what we are doing to address them. By openly telling the community where we are increasing our activities to address the causes of non-compliance, we aim to encourage people to voluntarily comply with their obligations. Since compliance risks can change during the year, we may vary the activities outlined in this publication in response to those changes and to your input to ensure that we continue to support high levels of voluntary compliance.

MANAGING REVENUE

We manage revenue through a range of collection systems, including income tax, goods and services tax (GST) – collected by the Australian Government on behalf of state and territory governments – superannuation and excise. We also administer a range of benefits and refunds, including the baby bonus, income tax and GST refunds, excise grants, family tax benefits and superannuation guarantee.

Income tax is the largest of the revenue systems that we administer. It includes personal tax, company tax, capital gains tax and taxation of superannuation funds (including the superannuation contributions surcharge). Income tax is estimated to account for around 73% of the total revenue we collected in 2005–06.

GST is a broad-based tax of 10% on the supply of most goods and services. There are 2.4 million businesses registered for GST, including charities and other non-profit organisations. GST is estimated to account for around 15% of the total revenue we collected in 2005–06.

We play a significant role in administering the superannuation system – there was around \$900 billion superannuation fund assets under management at the end of March 2006. Our role includes regulating self managed superannuation funds.

Excise duty is levied on the domestic production of alcohol, tobacco and petroleum products, generally based on their volume. The excise system also delivers fuel grants and administers the product stewardship for oil program. Excise is estimated to account for around 9% of the total revenue we collected in 2005–06.

OUR GENERAL APPROACH

We aim to maximise the number of people who choose to voluntarily comply by helping taxpayers and their advisers to understand their rights and obligations, and by making it as easy as possible for them to meet their obligations. At the same time, we have strategies to deter, detect and deal with non-compliance.

We try to find the right balance between our verification and enforcement activities (for example, audits, risk reviews and prosecutions), providing help (for example, education and advice) and making it easy to comply (for example, pre-populating electronic tax returns).

Our approach is founded on managing risk and responding quickly to changing circumstances. We monitor the revenue system to identify risks and develop appropriate compliance strategies. We then actively tell people about the risks, what our position is and what they can expect from us.

The taxpayers' charter and the compliance model (below) continue to guide our compliance work.

The charter is about being open and fair in our treatment of people, within the framework set by the law. It sets out our commitment to inform people of their rights, obligations and entitlements, and directs the way we behave towards the community and sets out what the community can expect from us. This relationship has a starting point of mutual trust and respect.

The compliance model directs that we better understand why people are not complying, and that we develop appropriate and proportionate responses.

Many factors – business, industry, sociological, economic and psychological – influence whether a person chooses to meet their obligations. The model (below right) shows a continuum of taxpayer attitudes towards compliance –

from taxpayers who have the desired attitude of being willing to do the right thing to taxpayers who have decided not to comply by choosing to evade tax or opt out of the system.

The model also summarises the different sorts of support and intervention that we may need to provide to collect the required revenue. The model suggests that we have the ability to influence taxpayer behaviour through our responses and interaction.

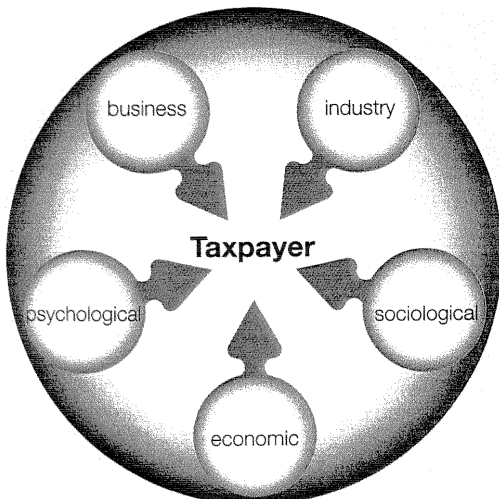
MARKET AND PRODUCT ANALYSIS

We tailor our compliance approaches to suit six market segments. This allows us to better differentiate our responses according to the level of risk presented by the characteristics and circumstances of each segment. The market segments are:

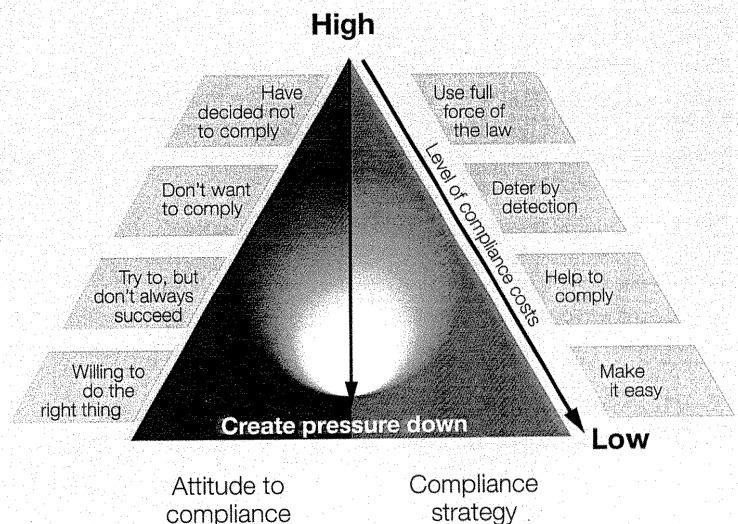
- individual taxpayers
- micro businesses – businesses with an annual turnover below \$2 million
- small to medium enterprises – enterprises with an annual turnover between \$2 million and \$100 million
- large businesses – business groups with an annual turnover above \$100 million
- non-profit organisations, and
- government organisations.

Each year, there are a few major risk areas that are common to many or all of the market segments, which we highlight in our key issues section. This year, we are focusing on international tax issues, aggressive tax planning, and serious evasion and fraud.

In this year's publication, we have introduced a separate section on intermediaries including chapters on tax practitioners, and employers and other intermediaries to better reflect their important roles in the revenue system.



Factors that influence taxpayer behaviour



We complement our market segment focus with analysis of the various taxes we administer and the key points of contact that taxpayers have with us, namely:

- registering in the system
- lodging forms
- reporting information, and
- making payments.

We focus on these areas because they are fundamental to taxpayer compliance. If taxpayers meet their obligations in these areas, the community can be confident that the revenue system is operating efficiently and effectively.

KEY COMPLIANCE ACTIVITIES

We have identified particular compliance risks that demand our attention in 2006–07. The additional funding we received from the government in this year's Federal Budget puts us in a better position to address a number of these risks.

These activities include:

- checking the compliance of the increasing number of very wealthy individuals
- dealing with promoters of aggressive tax planning schemes by using the new promoter penalty laws
- collecting outstanding debt
- combating serious evasion and fraud, particularly the use of tax havens, in consultation with other government organisations through Project Wickenby
- supporting the implementation of the new national legislative framework for tax practitioners' registration and regulation
- detecting identity crime to evade tax
- pursuing investors who fail to declare capital gains tax, and
- verifying the compliance of large businesses and developing a cooperative approach with those that want to do so.

OUR VERIFICATION ACTIVITIES

We verify compliance using a risk-management approach – that means the degree to which we scrutinise taxpayers' affairs depends on their level of risk of non-compliance with the tax law (whether non-compliance favours taxpayers or the revenue).

Where we identify a serious or widespread risk within part of a market segment, we increase and intensify our scrutiny. We also differentiate our approaches and responses between those taxpayers who are trying to do the right thing and those who are not.

Verification activity (and the statutory application of penalties or prosecution action) act as deterrents, encouraging taxpayers to comply with their tax obligations. Importantly, these activities support those taxpayers who want to do the right thing by ensuring that there are real and tangible risks for those who don't – this is all about fairness for honest taxpayers and a level playing field for business.

HOW WE HELP TAXPAYERS COMPLY

A large amount of our compliance effort goes into supporting people who want to do the right thing.

This includes providing taxpayers and their advisers with help and information through our:

- website – www.ato.gov.au
- dedicated phone services
- shopfronts
- market segment and topic-specific publications and products
- educational seminars and assistance programs
- access to our precedents and research materials, and
- oral and written advice and rulings.

We also try to make it easier for people to comply with their obligations by finding out how they want to deal with us and then offering products and services that make sense to them and are practical to use, for example the tax agent and business portals.

We outline these activities in more detail in our *Making it easy to comply* publication, which is available on our website.

STRUCTURAL FEATURES OF THE LAW REDUCE RISKS FOR TAXPAYERS

As a general rule, the tax law only expects taxpayers to exercise reasonable care (and have a reasonably arguable position where large matters are involved) in undertaking their tax obligations. The new shortfall interest charge reduces the rate of interest that may be payable for the period between the original assessment and a debit amended assessment.

The public binding rulings system and the private binding and reviewable rulings system provide certainty for taxpayers in areas of genuine uncertainty. The latter allowing taxpayers to be 'assessed' on the tax consequences of an existing or proposed transaction. Both public and private rulings provide protection for taxpayers but only bind the Commissioner.

Taxpayers have the right to object or appeal where they dispute a tax liability. These rights are explained in the taxpayers' charter.

01

OUR MARKET SEGMENTS

INDIVIDUALS
MICRO BUSINESSES
SMALL TO MEDIUM ENTERPRISES
LARGE BUSINESSES
NON-PROFIT ORGANISATIONS
GOVERNMENT ORGANISATIONS

Due to the size, nature and diversity of the revenue system and the taxpaying community, we broadly separate taxpayers into market segments. This enables us to develop strategies, products and services that best meet the needs of taxpayers in each segment.

This section outlines our general compliance approach and the specific compliance risks for each segment.

Individuals

REVENUE CONTRIBUTION

The tax paid by individuals makes up around 44% of the total tax we collect. Most individuals pay this tax through their employers, who withhold amounts from payments to their employees.

PROFILE

Around 11 million individuals lodge income tax returns. This includes approximately 1.8 million individuals who receive business income, either directly or through a partnership or trust. The rest are mainly salary and wage earners or private investors.

Tax agents prepare around 74% of the tax returns lodged by individuals. Of those individuals who prepare their own returns, an increasing number – almost 1.4 million in 2005–06 – lodge them online using e-tax (see box on next page). In 2006–07 we expect the number to exceed 1.7 million.

Approximately 79% of individuals receive a payment at the end of the year. Payments include refunds of tax already paid, tax credits and offsets, and other government benefits such as the family tax benefit.

Of the 11 million individuals who lodge income tax returns, around 1 million also participate in the pay as you go (PAYG) instalments system.

Non-compliance typically occurs in the following areas.

- **Registering** – a small proportion of individuals attempt to undermine the tax system by not registering, or registering incorrectly, forging identity documents, stealing identities or creating false identities.
- **Keeping proper records** – poor record keeping often contributes to incorrect claims. Too many individuals fail to keep adequate records, particularly of work-related expenses, rental expenses and investment properties, and cash receipts.
- **Lodging forms on time** – non-lodgment and late lodgment of returns and forms, particularly by high-profile individuals, are continuing concerns.
- **Reporting correct information and claiming valid entitlements** – the following practices often result in individuals over-claiming refunds:
 - incorrectly claiming deductions for work-related expenses
 - claiming deductions related to aggressive tax planning schemes
 - not declaring rental income and incorrectly claiming rental deductions
 - not declaring capital gains
 - not declaring income generally, and
 - avoiding tax by using international transactions and tax havens.
- **Paying tax on time** – the key risk here is from individuals who do not provide for unexpected bills, which can lead to unpaid debts and interest charges.

OUR GENERAL APPROACH

Our approach to increasing compliance among individuals is based on:

- ensuring that individuals and tax agents have access to all the information and support tools they need, and
- verifying information provided in returns.

We consult tax agents and representatives of the wider community when designing our information products and services. These include printed publications, short return forms for individuals with simple tax affairs, telephone enquiry services, and oral and written private rulings.

Our range of electronic services includes:

- e-tax
- calculators and decision support tools
- voice-activated telephone lodgment facilities
- a 24-hour self-help telephone enquiry service, and
- a wide range of help information on our website.

Our verification activities include:

- conducting computer checks when processing returns to detect common errors and inconsistencies
- conducting further checks where more information is required to resolve a query, especially in the case of high-risk refunds
- comparing returns after an assessment has been issued to detect those that fall outside normal patterns – for example, for a particular occupation
- profiling tax agents to detect those with unusual patterns of claims for their clients (see the 'Tax practitioners' chapter), and
- comparing data to detect inconsistencies between tax returns and information we obtain from third parties.

We amended over 237,000 individuals' returns last year after issuing the original assessments, while individuals self-amended over 350,000 returns.

KEY FEATURES OF e-tax

e-tax is an electronic tax return preparation package covering the annual tax return, plus a number of shorter returns where a full tax return is not required. The package:

- assists individuals through an online interview, progressively filling out their tax return
- incorporates an extensive range of online help facilities
- allows individuals to import some data from elsewhere, such as medical expenses and Centrelink payments, helping to ensure the return is complete and accurate
- performs most of the calculations for individuals' claims
- alerts individuals if they have made common mistakes or omissions, and
- gives individuals a detailed estimate of their assessment.

HEADLINE ISSUES

Each year we revise our compliance focus to treat new, emerging and existing risks.

New and expanded priorities

In 2006–07 we are placing more emphasis on:

- examining the tax affairs of high-income individuals
- detecting individuals who fail to declare income from the cash economy
- identifying unreported dividend, capital gains and rental property income
- improving compliance with PAYG instalments obligations
- pursuing lodgment of outstanding returns by high-risk taxpayers including some clients of Centrelink and the Child Support Agency
- ensuring the integrity of the tax file number system, including combating identity theft
- verifying that individuals with an Australian business number are entitled to have one, and
- ensuring that the new 30% child care rebate is correctly claimed by all eligible individuals (see box at right).

Continuing priorities

In 2006–07 we are continuing to focus on:

- checking refunds that match high-risk criteria, such as high levels of tax withheld compared to the salary and wage income declared
- specific occupations and types of work-related expenses that show higher trends than expected
- the legitimacy of claims for rent expenses
- helping individuals understand and meet their capital gains tax obligations
- monitoring transactions and reviewing arrangements involving tax havens and countries with bank secrecy laws, and
- deterring and detecting the involvement of individuals in aggressive tax planning, including schemes to avoid tax.

30% CHILD CARE REBATE

We have worked closely with the Family Assistance Office to update our systems. Claim data can be downloaded to e-tax or accessed via the Family Assistance Office website or our Tax Agent Portal. We are also providing information to tax agents and child care providers to help them explain the rebate to eligible parents.

All claims will be verified. If our records indicate that individuals are eligible to claim the rebate but have not done so, we will advise them to get in touch with us so that we can confirm their eligibility. They can then request us to amend their return so that they obtain their entitlement.

REGISTERING IN THE SYSTEM

We use data supplied by other government organisations to verify the identity of individuals applying for tax file numbers and the documentation they provide.

This year we are improving our activities to educate individuals, particularly visitors from overseas, about the use of tax file numbers and individuals' obligations.

We identify individuals operating outside the system or attempting to lodge fraudulent tax returns. In particular, we investigate cases where an individual has created or adopted a false identity to fraudulently obtain benefits from the revenue or welfare system (see the 'Serious evasion and fraud' chapter).

To maintain the integrity of the Australian Business Register, we are reviewing individuals with Australian business numbers to ensure they have an ongoing eligibility, and will cancel these numbers where they do not.

MEETING LODGMENT OBLIGATIONS

We are still concerned about the risks posed by individuals not lodging returns and forms, or lodging late, especially those:

- whose non-compliance poses a high risk to revenue, including:
 - those we expect to have high levels of tax payable, and
 - promoters of tax schemes and individuals who are using tax havens
- who are in high-profile professions and influential in the wider community, including:
 - legal professionals, tax agents, politicians, financial planners and consultants
 - professional sportspeople, entertainers and senior public servants
 - very high wealth individuals, and
 - individuals who control businesses or corporations, and
- who have child support obligations or are recipients of Centrelink benefits.

We apply these risk assessment criteria to annual returns and activity statements.

A high proportion of individuals use tax agents, so we monitor the lodgment activities of tax agents closely.

We continue to enforce superannuation surcharge obligations that existed before the surcharge was abolished on 1 July 2005.

REPORTING CORRECT INFORMATION

Most individuals who report incorrect information do so inadvertently through a lack of awareness, an inability to understand tax concepts, calculation mistakes, or a failure to seek appropriate assistance.

Last year we ran checks on the returns of over 10 million individuals. From these, we selected nearly 348,000 for follow-up contact. This year, we expect to contact at least 329,000 individuals. They may be contacted by letter or telephone, audited, or asked to provide more information in a schedule.

We review and amend claims where necessary, and penalties apply where an individual has not taken reasonable care.

High-risk refunds

Before we issue refunds, we check them against a set of criteria based on intelligence from our compliance activities. We may:

- match the return information with data supplied by third parties, including employers
- contact an individual or their tax agent to get more detail on particular information in the tax return
- contact an individual's employer to verify employment details, or
- undertake further audit investigation.

Last year we ran checks on the returns of over 10 million individuals. From these, we selected nearly 348,000 for follow-up contact.

Deductions for work expenses

Around 7 million individuals collectively claimed \$11.5 billion in deductions for work-related expenses in 2004–05. Both the number and the value of such claims increased from the previous year.

Before 2005–06 returns are due, we will have written to over 210,000 employees we consider to be at risk of not complying, pointing them to information about claiming work-related expenses and asking them to take particular care with their claims. We will ask around 15,000 of those employees to provide extra supporting information – for example, logbooks to substantiate motor vehicle expense claims.

We will conduct around 15,000 reviews or audits of at-risk cases, such as where:

- claims for deductions seem high or excessive compared to the salary and wage income declared
- claims for deductions are outside the regular pattern for a particular occupation or industry
- we have sent an advisory letter to the individual before tax time and their claims have increased above expected trends, or
- there has been no response to earlier requests for information.

Each year we select particular occupations or industry groups for special attention, based on analysis of their claim patterns in the previous year. This year we are focusing on:

- employee business professionals, including accountants
- hospitality industry service workers
- factory hands, store workers and process workers
- mechanical, automotive and electrical tradespeople
- information technology professionals, and
- mining site employees.

We will visit 300 tax agents with abnormal claim patterns to review a sample of their clients' returns. Where we detect a high incidence of inaccurate claims or common mistakes, we will undertake further audit activity.

Rental income and expenses

The percentage of investors reporting losses on rental investments continues to grow. We are remaining vigilant in this area to ensure that individuals are claiming in accordance with the law.

This year we have written to 76,000 individuals who enter the rental market last year to ensure that they understand how to declare rental income and claim deductions correctly. We have also written to 45,000 individuals who are at risk of not complying to remind them to check the accuracy of their claims before lodging their returns.

We look for individuals:

- claiming deductions for a property that is not genuinely available for rent, or claiming full deductions where property is available for rent for only part of the year
- claiming initial repair or renovation costs as repair and maintenance costs, rather than correctly attributing these to the capital cost of the property
- incorrectly apportioning deductions related to private borrowings or travel, and
- incorrectly claiming deductions against rental income for legal and other costs that should be treated as capital expenses.

We use land tax data from state revenue offices to identify individuals who own investment properties, holiday homes or units, and check that they have declared the rental income in their returns.

We will examine around 6,000 at-risk cases this year. This will include contacting tax agents whose clients have unusual patterns of rental claims.

Capital gains tax

This year we will compare tax returns with information from state revenue offices and other government agencies, Australian Stock Exchange and share registries, as well as information reported by managed funds.

We are writing to 23,000 individuals who purchased investment property, shares or units in a managed fund in 2005–06 to inform them of their capital gains tax obligations if they dispose of these assets.

Before 2005–06 returns are due, we will have sent letters to around 5,000 individuals who appear to have made large capital gains, or whose managed fund indicated large capital gain during the year, to alert them to their obligation to report capital gains.

We will provide advice, rulings and fact sheets to individuals involved in share buy-backs to increase awareness and understanding of the issues involved.

Where an individual fails to disclose or significantly under-reports a capital gain, we will conduct a review or an audit. We will examine around 6,000 at-risk cases this year.

High-income individuals

We are reviewing the tax affairs of some senior company executives whose total remuneration exceeds \$1 million, examining incentives such as options, rights issues, cash bonuses and non-income capital benefits. We will conduct audits where we identify a high risk of omitted or under-declared income.

Aggressive tax planning

Most adjustments of individuals' returns arising from aggressive tax planning arrangements currently relate to:

- capital protected products – generally shares or other securities purchased using a limited recourse loan facility that allows the transfer of the shares or securities back to the lender to satisfy the obligations under the loan, and
- prepaid service warrants – said to be redeemable by the provision of legal and other professional services – used to generate large losses for an individual or partnership that acquires the warrants.

We will also gather information to identify new or emerging aggressive tax planning arrangements through the examination of partnership returns where a loss is distributed to an individual.

For more information, see the 'Aggressive tax planning' chapter.

Cash economy participation

We are concentrating on detecting individuals who earn income from casual employment and fail to declare some or all of it (see the 'Micro businesses' chapter).

Income matching and benefits checking

Information reported to us by third parties (see the 'Employers and other intermediaries' chapter) is compared with tax returns to identify discrepancies. This year we will match at least 48 million transactions.

We compare information to verify details such as:

- employment income, including salary and wages, allowances, lump sum payments and reportable fringe benefits
- government benefits and other payments
- interest and dividend payments, and
- health insurance premiums paid, and the period of cover.

We follow up any discrepancies with individuals and give them the opportunity to check the information from other parties. Where necessary, we amend the return and penalties may apply.

This year we plan to contact some 250,000 individuals about such discrepancies. This is expected to raise around \$120 million in tax.

GIVING INDIVIDUALS AND TAX AGENTS ACCESS TO INFORMATION FROM THIRD PARTIES

Comparing tax returns with information from third parties involves additional work for the Tax Office, individuals and their agents. Making third-party data available to individuals before they lodge their returns would help individuals get their returns right the first time, rather than having to amend them. We are already working to do this for e-tax users. We also want to make this data accessible to individuals who use tax agents, most of whom lodge returns electronically.

As a first step, last year we trialed an arrangement with Centrelink and the Health Insurance Commission that enabled e-tax users to download their benefits income and health expenses data to e-tax. We intend to widen the scope of this activity to include other data such as bank interest.

This year we are trialing another approach, using data provided by the Family Assistance Office to help individuals prepare their claims for the new 30% child care tax rebate. Individuals can import the data into their e-tax return, and tax agents also have access to the data.

Information reported to us by third parties is compared with tax returns to identify discrepancies. This year we will match at least 48 million transactions.

International tax issues

This year we are focusing on Australian residents who fail to disclose:

- overseas capital gains or income from employment, pensions, dividends, interest or rent, or
- profits accumulated in overseas investments – including companies and trusts – that are subject to Australian tax.

We are also focusing on non-residents who fail to declare:

- Australian capital gains – for example, from real estate and share transactions, or
- Australian rental, employment or pension income.

We will contact 1,000 individuals who appear not to have declared such income.

To address the misuse of tax havens by individuals, we are:

- using information about international flows of funds to identify non-compliance, including non-lodgment of returns
- targeting the offshore and onshore promotion and facilitation of haven-based bank arrangements, and
- scrutinising the returns of individuals who use offshore credit and debit cards, which are often an indicator of tax evasion.

Superannuation

We are:

- detecting individuals who improperly access their superannuation before retirement
- advising individuals who have received excessive eligible termination payments or pensions about their tax obligations
- requesting individuals' tax file numbers to enable their co-contribution to be paid to their superannuation fund, and
- detecting individuals who have not included reportable fringe benefit amounts in their income tax returns. Amended income tax assessments may result in amended surcharge and co-contribution assessments.

MEETING PAYMENT OBLIGATIONS

If an individual has difficulty in paying, they can arrange to pay by instalments. Where paying a debt will cause serious hardship to an individual, we explain their options including how they can apply for release from the debt.

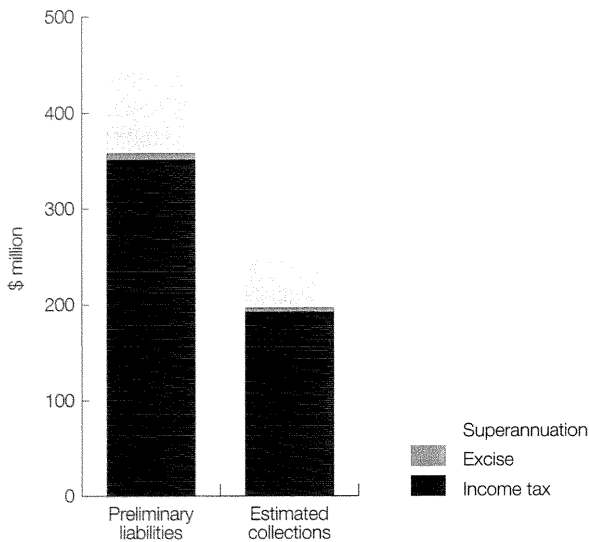
If an individual fails to come to an arrangement with us to comply with an agreed arrangement, we will take action to recover the outstanding amount. This may include issuing garnishee notices or commencing bankruptcy proceedings.

COMMISSIONER'S ADVICE

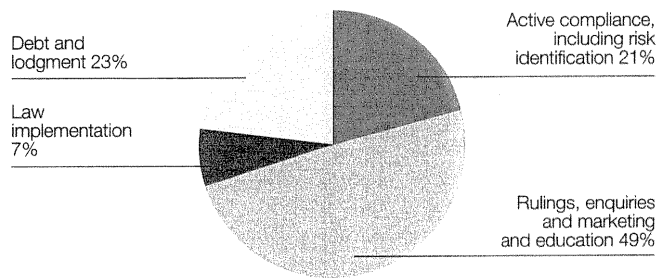
- The earlier you send in your tax return, the earlier you will receive your refund.
- If you are expecting a tax bill instead of a refund, you can still lodge early – you won't have to pay until 21 November 2006.
- If you claim work-related expenses, you must be able to show that the deductions relate to your income and how you calculated the amount. If your deductions are more than \$300 for work-related expenses you will also need to keep records to prove the total amount, not just the amount over \$300.
- You can find online calculators, a range of publications and other information specifically for individuals at www.ato.gov.au/individuals
- If you have any problems meeting your obligations – including lodging your return or paying your tax on time – you can telephone us on **13 28 61**, 8.00am to 6.00pm, Monday to Friday, to discuss your situation.

PRELIMINARY RESULTS FOR 2005–06

Preliminary liabilities and estimated collections 2005–06^{1,2}



Preliminary individuals segment expenditure 2005–06



- 1 Results include activities undertaken to prevent the issue of incorrect refunds or payments. For 2006–07, we are examining how we may separate pre-issue active compliance activities.
- 2 Commencing 2005–06, lodgment enforcement is included in our compliance activities.

Highlights of key activities

Income tax

- Last year we ran checks on the returns of over 10 million individuals. From these, we selected nearly 348,000 for follow-up contact.
- Work-related expenses – we sent letters to 226,000 individuals asking them to review their claims before they lodged their returns, resulting in revenue savings of \$14.7 million; 16,500 reviews or audits were completed, resulting in revenue adjustments of \$14.9 million.
- Rental income and expenses – we sent letters identifying our area of concern to 145,000 individuals requesting them to review their claims before they lodged their returns, resulting in revenue savings of \$8.7 million; 6,900 reviews or audits were completed, resulting in revenue adjustments of \$6.9 million.
- Capital gains tax – we reviewed or audited 9,500 returns that failed to fully disclose capital gains tax events, resulting in revenue adjustments of \$40 million. We also wrote to 5,400 individuals involved in property sales to alert them to their potential capital gains tax obligations, which resulted in an estimated \$7.6 million in additional revenue.

- Income matching and benefits checking – by comparing third-party information against returns, we identified 251,000 discrepancies, resulting in revenue adjustments of \$129 million.
- High-risk refunds – we reviewed 31,500 returns, resulting in revenue adjustments of \$41 million.
- Lodgment compliance – 19,700 income and fringe benefits tax returns and 19,600 activity statements were finalised through targeted enforcement action, resulting in \$51.4 million raised in liabilities. 840 cases were subject to prosecution action.

Superannuation

- 1,250,000 letters were sent to individuals informing them that they may have lost track of their superannuation.
- 546,800 accounts from the Lost Members Register were reunited with members.
- 22,900 income tax lodgments resulted from following up high-income earners who had not lodged, raising \$11.8 million in surcharge liabilities.

Micro businesses

REVENUE CONTRIBUTION

The tax paid by micro businesses makes up around 11% of the total tax we collect.

Of the various taxes we collect, micro businesses contribute:

- 13% of all income tax from companies
- 67% of all other income tax*
- 25% of all goods and services tax
- less than 1% of all wine equalisation tax and luxury car tax
- less than 1% of all fringe benefits tax, and
- less than 1% of all excise.

On behalf of their employees, micro businesses also contribute a further 7% of total tax collected, through the amounts they withhold from payments to their employees.

* Other income tax includes collections from individuals from pay as you go instalments, debits on assessments, superannuation funds, superannuation surcharge, petroleum resource rent tax and refunds to individuals.

PROFILE

There are around 2.4 million micro businesses – businesses with an annual turnover below \$2 million – in Australia, collectively employing around 4 million people during the year. They include around 300,000 small superannuation funds and 200,000 trusts.

Around 96% of all businesses in the revenue system are micro businesses. More than 60% of micro businesses are in the property and business services, construction services, finance, primary production or retail industries. Around 60% operate as sole traders or partnerships.

Many micro businesses have limited time, knowledge and resources for managing tax affairs. Although most prepare their own business activity statements, 95% have their income tax returns prepared by tax agents.

Although micro businesses generally comply with their tax obligations, non-compliance typically occurs in five key areas.

- **Registering** – some micro businesses fail to participate fully in the tax system – for example, a business may enter and exit the system repeatedly, or pay wages but not make superannuation contributions.
- **Record keeping** – a significant proportion of micro businesses fail to keep adequate records to support their returns. This is often associated with cash economy activity.
- **Lodging on time** – a small proportion of micro businesses fail to lodge their activity statements on time, but a larger proportion fail to lodge income tax returns on time.
- **Reporting information and claiming entitlements** – inexperienced operators sometimes misunderstand their reporting obligations (each year, around 10% of micro businesses are new businesses). Errors also arise from changes to tax rules or unusual or infrequent transactions, or from a small minority of businesses seeking to avoid their obligations. Further, income may not be reported correctly in relation to personal services, claims for losses, and by some clients of tax agents with a higher incidence of mistakes.
- **Paying tax on time** – micro businesses often fail to provide for their tax liabilities and then cannot make payments when they are due. For the 2005–06 financial year, 67% of the total debt outstanding to us was owed by micro businesses.

OUR GENERAL APPROACH

Our approach to maximising compliance among micro businesses is based on:

- ensuring they have the information and support they need to comply with their tax obligations
- identifying practices that are at high risk of being non-compliant, and alerting them to these practices, and
- taking firm action against those that deliberately or persistently fail to comply.

We provide information and education services to help micro businesses understand and comply with their obligations, including practical record keeping tools tailored to their needs.

While the law provides optional methods for calculating and reporting, we have expanded on this to administratively provide an even greater range of more flexible and tailored methods for calculating and reporting both income tax and goods and services tax (GST).

We conduct record keeping reviews to support compliance and best business practice. We also encourage micro businesses to deal with us electronically rather than by using paper forms. This reduces errors, turnaround times and costs for both parties.

We often communicate with micro businesses through intermediaries such as tax agents, bookkeepers, industry associations or software developers. We also collaborate with these intermediaries to improve our combined understanding of compliance risks and to co-design solutions that address the causes of non-compliance – whether that be lack of information, common errors (both advantageous and disadvantageous to taxpayers) or intentional activity.

We compare information supplied by a range of government organisations and financial institutions (see the 'Employers and other intermediaries' chapter) with the information provided in tax returns and activity statements to:

- identify businesses that are reporting inaccurately or operating outside industry or economic norms, so that we can review cases of non-compliance and monitor changes in trends, and
- identify businesses that pose little or no risk to the revenue system, so that we can minimise demands on them.

HEADLINE ISSUES

Each year we revise our compliance focus to treat new, emerging and existing risks.

New and expanded priorities

In 2006–07 we are placing more emphasis on:

- identifying high-risk cases earlier and more accurately
- expanding our capability to enforce lodgment obligations
- better integrating case management to ensure that:
 - when we contact a taxpayer about a specific compliance failure, we also review their compliance with other obligations, and
 - issues are resolved in the shortest possible time
- providing education and assistance and verifying activity statements to ensure the effective introduction of new fuel tax credit arrangements, and
- providing education and assistance on the entrepreneurs' tax offset, and verifying compliance with this measure.

Continuing priorities

In 2006–07 we are continuing to focus on:

- targeting taxpayers who deliberately and persistently fail to report cash income or business-to-consumer transactions
- monitoring the compliance of self managed superannuation fund trustees
- providing timely and practical advice to micro businesses
- helping new businesses to develop and apply sound tax management practices, and monitoring them to identify problems they encounter in the early stages of their business
- reviewing the record keeping practices of micro businesses, particularly in industries that are active in the cash economy
- checking high-risk refunds before they are issued, and
- checking that employers comply with their pay as you go (PAYG) withholding, fringe benefits tax and superannuation obligations.

REGISTERING IN THE SYSTEM

We review the registration of micro businesses by:

- comparing information from external sources (see the 'Employers and other intermediaries' chapter) with the information and documentation provided by businesses
- making unannounced, face-to-face visits to businesses, particularly in high-risk industries, and
- conducting reviews to ensure that registered entities are actually carrying on a business.

This year we will undertake 1,750 reviews to check that businesses are properly registered and, if so, are actually carrying on a business.

We are focusing on:

- identifying and dealing with businesses that enter and leave the revenue system repeatedly without meeting their tax obligations
- profiling new trustees of self managed superannuation funds to check their eligibility to act as trustees, and other risk areas such as residency and inappropriate early access
- checking that property developers are properly registered for GST
- assessing businesses that manufacture alcohol, tobacco or petroleum products, and granting licences to suitable applicants, and
- registering businesses for the fuel tax credits system, which substantially replaces the energy grants credits scheme from 1 July 2006. The new system significantly increases the number of micro businesses eligible for fuel credits.

MEETING LODGMENT OBLIGATIONS

While a small proportion of micro businesses fail to lodge activity statements on time, a larger proportion fail to lodge income tax returns on time.

To improve compliance, this year we are focusing on:

- new businesses that fail to lodge on time
- businesses involved in the tax, legal, sports promotion, or arts and entertainment professions
- businesses that operate in industries where international, cash and/or criminal dealings are common
- businesses identified as high risk through Project Wickenby (see the 'Serious evasion and fraud' chapter)
- businesses with significant turnover or high levels of tax payable
- business operators with child support obligations
- promoters of tax schemes and businesses that use tax havens and/or international transactions
- self managed superannuation funds regarding their income tax and regulatory returns, and member contributions statements, and
- small funds regulated by the Australian Prudential Regulation Authority regarding their income tax returns and member contributions statements.

REPORTING CORRECT INFORMATION

This year we will phone or visit 13,000 new and established micro businesses to help them understand all their tax obligations and report correct information.

Record keeping

We provide tools and information to help businesses improve their record keeping, including:

- free *e-Record* record keeping software and a record keeping evaluation tool
- the *Record keeping for small business* booklet, and industry-specific record keeping fact sheets
- an online register of commercially available software products that meet Tax Office requirements, and
- free record keeping workshops.

We continue to visit micro businesses to review their records and, where the records are unsatisfactory, advise how they can improve them. Analysing the information we obtain from these visits helps us refine our strategies to assist the industries and groups of businesses with the highest levels of risk.

If we find that a business has disregarded our advice and their records remain unsatisfactory, penalties apply. We follow a graduated approach, with the penalty imposed reflecting the efforts made to improve record keeping.

Cash economy participation

To discourage participation in the cash economy, in 2006–07 we will make contact with over 55,500 taxpayers through a variety of activities including:

- writing to taxpayers who report amounts outside industry norms in their activity statements, asking them to confirm the information is accurate
- making unannounced visits to businesses to check their identification and registration details, and
- conducting audits of businesses.

We are targeting industries that are active in the cash economy, including:

- building and construction
- used motor vehicle wholesaling and retailing
- restaurants, cafes and take-away food outlets
- licensed hotels and registered clubs
- horse racing, and
- fishing.

We are also examining trends and cases of potential non-compliance involving:

- businesses that cash business income cheques at cheque cashing shops
- nail salons, and
- market stall holders.

We help micro businesses understand and comply with their obligations, and highlight the consequences of not complying. We take firm action against businesses that deliberately avoid their obligations.

This year we are focusing on:

- identifying business-to-consumer transactions that do not comply with tax requirements (including the use of third party data)
- increasing the frequency of our communications, including through the media, tax agents, our website and direct contact with taxpayers
- following up information from the community about businesses that might be avoiding their tax obligations
- collaborating with tax agents, bookkeepers and industry organisations to improve our combined understanding of compliance issues and to co-design solutions
- encouraging industries to self-regulate and develop codes of conduct
- working with other government organisations, such as Centrelink and the Department of Immigration and Multicultural Affairs, to identify and examine cases of mutual interest, and
- comparing information provided in returns and activity statements with information from other sources to identify high-risk cases for review.

Goods and services tax

To improve compliance, this year we will:

- phone and/or visit micro businesses to check the accuracy of information submitted in 7,100 activity statements
- conduct 600 reviews and audits to deal with GST non-compliance in property transactions
- undertake around 780 comprehensive audits of businesses where we believe there may be serious evasion and fraud, and
- check 55,500 refunds to improve GST compliance.

We are also improving our capabilities for identifying high-risk refunds so they can be reviewed before being issued. Recognising that businesses are entitled to prompt refunds, we help them meet their reporting obligations so that refunds can be issued without delay. We also review lower-risk cases after refunds have been issued.

Employer obligations

This year we will review around 3,700 cases where information reported against various employment obligations is inconsistent, for example:

- where amounts claimed as credits by employees in their tax returns do not match the amounts reported by employers, or
- where an employer is registered under a workers' compensation scheme but is not registered for PAYG withholding.

We continue to improve our understanding of the compliance problems of employers, and tailor our intervention strategies to help them comply.

Since 2000 there has been a 28% decrease in the number of micro business employers lodging fringe benefits tax returns, and a 56% reduction in the amount of fringe benefits tax they paid. We are analysing information from a range of sources to improve our understanding of the reasons for these reductions. Of the 3,700 cases mentioned above, around 2,600 will include fringe benefits tax checks. In addition, we will also conduct at least 100 reviews or audits of micro business employers at highest risk of not meeting their fringe benefits tax obligations.

To improve compliance with superannuation obligations, this year we are:

- following up all employees' claims that their employers have not offered them choice of superannuation fund or are not making superannuation payments on their behalf, and
- auditing employers identified as being at high risk of not complying.

We will conduct a study of employers whose behaviour indicates non-compliance with superannuation guarantee or choice obligations. The purpose of the study is twofold – to get a better understanding of reasons for non-compliance and to develop strategies to encourage future compliance.

Personal services income

We are examining the status of personal services businesses to verify whether they legitimately pass one of the personal services business tests. We pay close attention to deductions that are not allowed by the legislation.

We will review 270 taxpayers who may be subject to the alienation of personal services income legislation.

We are also improving our capabilities for identifying high-risk (GST) refunds so they can be reviewed before being issued.

Losses

This year we will:

- review 200 claims for losses that may not be eligible to be claimed in the current year under the non-commercial losses rules
- complete our current reviews of a number of consolidated groups to identify incorrect consolidated memberships, and
- continue our focus on the eligibility of participants in the boat charter industry to claim business losses.

Tax agents

We will contact a tax agent if their clients have a high incidence of making inaccurate claims or common mistakes, or are operating outside industry norms. Where this occurs, we will give the agent an opportunity to explain trends, verify information and discuss work practices, particularly in regard to tax return preparation.

This year we will visit 35 agents and review the affairs of three clients per agent, on average.

Superannuation funds

We are continuing to improve the timeliness, accuracy and completeness of superannuation fund lodgments and reporting by:

- providing information to all newly registered self managed superannuation funds to help trustees understand their obligations
- auditing funds at high risk of not complying
- checking member contributions statements to ensure that personal contributions are reported correctly for co-contribution payment purposes
- reviewing high-risk regulatory issues, such as whether a fund has met the in-house asset rules, and
- following up auditor contravention reports.

We are also collaborating with superannuation fund trustees and tax practitioners to raise awareness of the tax issues that arise when trustees of self managed funds move overseas.

Capital gains tax

This year we aim to improve compliance by educating micro businesses about their capital gains tax obligations. In particular, we are tailoring information products and tools to help businesses and tax practitioners understand:

- the changes to the small business concessions announced in the 2006 Federal Budget
- the eligibility requirements for small business concessions, particularly the retirement exemption and the active asset reduction concession
- the correct way to apply capital gains tax to trust distributions, and
- the correct use of capital losses.

We compare information from external sources with information provided in returns to ensure that capital gains and losses are being reported and claimed appropriately, particularly for transactions that involve:

- property
- shares
- the charter boat industry, and
- the fishing industry.

We monitor asset disposals and transfers particularly to superannuation funds. Our aim is to identify cases that involve aggressive tax planning, inappropriate valuations or complex structures designed to avoid or minimise capital gains tax.

International tax issues

Businesses involved in international tax transactions have an obligation to lodge correct returns and required schedules, and to withhold tax from payments to foreign residents.

This year we aim to improve compliance by educating and helping micro businesses understand and comply with their tax obligations in this area, and taking firm action against businesses that deliberately fail to comply.

We continue to focus on:

- the use of tax havens to conceal assets, launder money, or reduce, avoid or evade tax, and
- the promotion of aggressive tax planning schemes that use international transactions.

For more information, see the 'International tax issues' chapter.

Excise

We are providing information and assistance to ensure that micro businesses, and tax practitioners, understand the entitlements and obligations under the fuel tax credits system. This system substantially replaces the energy grants credits scheme from 1 July 2006.

We continue to improve compliance in the tobacco industry by:

- promoting self-regulation for businesses at low risk of not complying, and
- intervening in high risk cases involving possible non-compliance or continued low-level non-compliance.

In particular, we are working to deter, detect and deal with the illicit supply of tobacco leaf (see the 'Serious evasion and fraud' chapter).

MEETING PAYMENT OBLIGATIONS

Our primary focus is on businesses with longstanding debts that did not take the opportunity to make arrangements with us under the 2004–05 small business debt assistance initiative.

We are also introducing new software tools that can better identify businesses that do not settle their debts within a reasonable period. We will take fair but firm action, including garnishee and court action, in such cases.

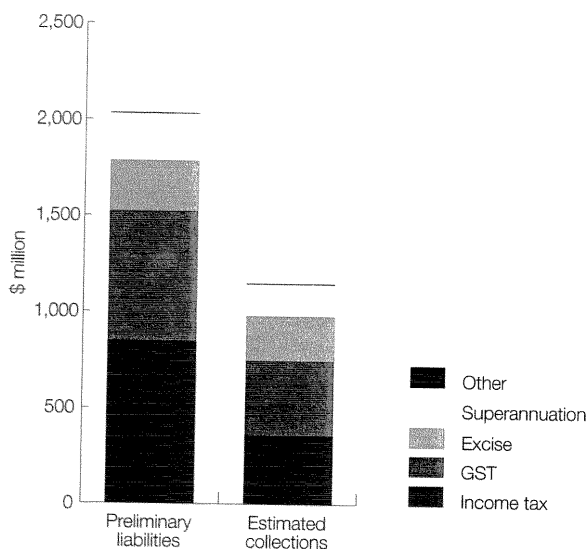
COMMISSIONER'S ADVICE

- If your business lodges and pays its quarterly activity statement online, it may be eligible for a two week deferral of the due date in the first, third and fourth quarters.
- You have to lodge an income tax return for each year you are in business – even if you do not make a profit or have to pay any tax.
- You can find our checklist for new businesses and information specifically for micro businesses at www.ato.gov.au/business
- Our free electronic record keeping product is available at www.ato.gov.au/erecord
- If you have any problems meeting your obligations – including settling past debts with us – you can telephone us on **13 28 66**, 8.00am to 6.00pm, Monday to Friday, to discuss your situation or enter into a regular payment arrangement.

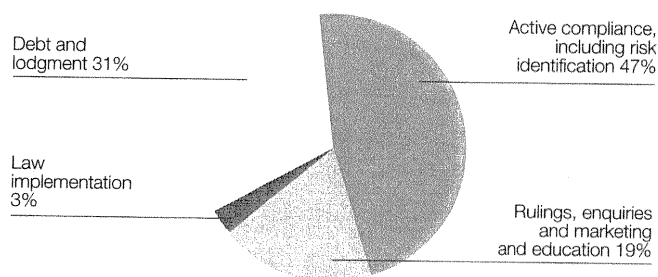
Our primary focus is on businesses with longstanding debts that did not take the opportunity to make arrangements with us under the 2004–05 small business debt assistance initiative.

PRELIMINARY RESULTS FOR 2005–06

Preliminary liabilities and estimated collections 2005–06^{1,2}



Preliminary micro businesses segment expenditure 2005–06



1 Results include activities undertaken to prevent the issue of incorrect refunds or payments. For 2006–07, we are examining how we may separate pre-issue active compliance activities.

2 Commencing 2005–06, lodgment enforcement is included in our compliance activities.

Highlights of key activities

Income tax

- 130 income tax reviews and 2,900 income tax audits undertaken, resulting in additional revenue of \$7.1 million and \$135.1 million respectively.
- Non-commercial losses – 940 reviews conducted, raising additional revenue of \$1.4 million.
- Employer obligations – 1,600 reviews undertaken and 2,300 businesses audited for compliance with their PAYG withholding, superannuation guarantee and fringe benefits tax obligations, raising revenue of \$111.9 million. There were also 23,600 PAYG withholding liability integrity reviews conducted that focused on discrepancies between employers' payment summaries and their activity statements. These reviews raised \$77.9 million in liabilities.
- Alienation of personal services income – 450 reviews conducted, resulting in additional tax and penalties of \$2.6 million.
- International income tax issues – 85 reviews conducted, improving awareness of international issues among micro businesses.

Lodgment

- We finalised through targeted enforcement action 31,100 income tax and fringe benefits tax returns, and 122,500 activity statements, raising liabilities of \$312.7 million. In addition, 4,400 cases were subject to prosecution action.

GST

- 4,200 telephone and field verification checks conducted, raising liabilities of \$74.8 million in GST and \$16.1 million in other taxes.
- 51,800 GST refund checks undertaken, resulting in \$244.2 million of incorrectly claimed GST refunds and \$4.5 million of incorrectly claimed refunds of other taxes being stopped.
- 430 audits relating to serious non-compliance conducted, raising liabilities of \$22.2 million in GST and \$19.7 million in other taxes.
- 450 audits with a specific focus on property transactions completed, raising liabilities of \$42.8 million in GST and \$1.7 million in other taxes.

Cash economy

We wrote to, telephoned or visited 54,400 businesses. Our compliance activities raised \$81.2 million in total liabilities and specifically included:

- 370 cases where we used business-to-consumer information to determine if income had been omitted
- 14 visits to major construction sites to obtain information on payments made by major subcontractors to micro contractors and employees, and
- sending educational letters to over 12,000 people and businesses across the fishing industry. 150 operators identified as being directly involved in catching fish were reviewed using state and federal government information to detect omitted income, particularly the non disclosure of sales of licences and quotas.

Superannuation

- 22,900 employee complaint and referral cases actioned in relation to employers' superannuation guarantee obligations, with 7,700 cases raising \$206.6 million in revenue.
- All employers contacted to advise them of legislative changes to their employer obligations for superannuation.
- 26,900 superannuation funds contacted to make sure they lodged income tax returns. 8,700 income tax returns were lodged. 4,000 audits of self managed superannuation funds were undertaken.
- 140 seminars that included information on self managed superannuation funds were conducted by our tax education speakers and seminars area.
- All new self managed superannuation funds issued with new trustee guides.

Tax havens

- 30 audits of cases involving a tax haven dealing were conducted, raising \$3.1 million in taxes and penalties.

Excise

- 880 visits to tobacco growers undertaken during the growing season to ensure crops were properly recorded and accounted for, and licence conditions met.
- All excise clients advised of changes to the excise regime as a result of excise tariff reform.
- 6,800 fuel grants claims reviewed, with 1,400 warranting adjustments, predominantly in the road transport industry. Of these, 17 were referred for further investigation and possible prosecution.

Small to medium enterprises

REVENUE CONTRIBUTION

The tax paid by small to medium enterprises makes up around 11% of the total tax we collect.

Of the various taxes we collect, small to medium enterprises contribute:

- 21% of all income tax from companies
- 8% of all other income tax*
- 35% of all goods and services tax
- 22% of all wine equalisation tax and luxury car tax
- 21% of all fringe benefits tax, and
- less than 1% of all excise.

On behalf of their employees, small to medium enterprises also contribute a further 10% of total tax collected, through the amounts they withhold from payments to their employees.

* Other income tax includes collections from individuals from pay as you go instalments, debits on assessments, superannuation funds, superannuation surcharge, petroleum resource rent tax, and refunds to individuals.

PROFILE

There are over 95,000 small to medium enterprises – enterprises with an annual turnover between \$2 million and \$100 million – in Australia, collectively employing more than 3 million people during the year.

They consist of around:

- 82,400 single entities, including around 440 superannuation funds regulated by the Australian Prudential Regulation Authority
- 12,100 groups (representing 44,000 members), including 7,800 self managed superannuation funds, and
- 900 high-wealth individuals, who each control net wealth of \$30 million or more.

More than 85% of small to medium enterprises have an annual turnover of less than \$10 million and most use simple business structures. Those with a higher turnover often involve multiple entities, and some include offshore entities.

Around 92% of small to medium enterprises are privately owned, and many are part of a larger group controlled by one or a few individuals. In general, these businesses are not subject to the same level of regulatory control and disclosure requirements as public companies.

Although small to medium enterprises generally comply with their routine tax obligations, their capacity to meet their obligations varies, particularly with complex or unusual transactions. Some small to medium enterprises adopt relatively aggressive tax practices.

Non-compliance typically occurs in four key areas.

- **Registering** – some small to medium enterprises do not participate fully in the tax system. For example, a business might be registered for income tax and goods and services tax (GST), but not for pay as you go (PAYG) withholding.
- **Keeping proper records** – some small to medium enterprises do not keep adequate records for unusual or infrequent transactions, such as international transactions, purchases or sales of assets, or loans to shareholders.
- **Lodging forms on time** – most small to medium enterprises lodge their activity statements on time, but we are concerned about the late lodgment of income tax returns, particularly by businesses that are making a loss.
- **Reporting correct information and claiming valid entitlements** – a significant number of small to medium enterprises make errors in reporting complex, unusual or infrequent transactions, and/or fail to properly report international transactions.

OUR GENERAL APPROACH

Our approach to maximising compliance among small to medium enterprises is based on:

- ensuring they have the information and support they need to comply with their tax obligations
- identifying practices that are at high risk of being non-compliant, and alerting them to these practices, and
- taking firm action against those that deliberately or persistently fail to comply.

In designing our information products and services, we consult peak bodies and individuals who represent the interests of the diverse small to medium enterprise segment.

We compare information provided by small to medium enterprises with information supplied by third parties, such as employers, financial institutions or government organisations (see the 'Employers and other intermediaries' chapter) to identify those that are at high risk of not complying.

We consider such factors as whether a business is making a loss, or is engaged in international transactions or transactions with related entities. We also plot the tax outcomes of businesses against reasonable expectations of profitability based on industry norms. To understand the risk posed by particular high-wealth individuals, we check whether tax performance is in line with economic performance.

Where we find an entity engaging in high-risk tax practices, we write, telephone or visit them to obtain more information. We also identify related entities and expand our investigations to profile the tax performance of the group as a whole, including the controlling individuals.

If we identify a new or common compliance issue, we alert other small to medium enterprises that are at high risk of not complying or not accessing an entitlement. For example, we may release a ruling or a guide that outlines what practices will attract particular scrutiny and why, or better explain the availability of an entitlement.

Where we find that small to medium enterprises have deliberately not complied with their obligations, statutory penalties apply to deter them from repeating the practice and to deter others from adopting similar approaches.

HEADLINE ISSUES

Each year we revise our compliance focus to treat new, emerging and existing risks.

New and expanded priorities

In 2006–07 we are placing more emphasis on:

- monitoring and reviewing compliance by 1,000 of our wealthiest individuals
- monitoring the overall tax performance of privately held groups and the individuals controlling them, and investigating cases where the tax performance of the group is out of line with its economic performance or the wealth accumulated by connected individuals, and
- checking that small to medium enterprises are properly reporting all required information, including by checking that:
 - businesses making losses lodge their income tax returns and correctly calculate losses
 - directors and senior officers of businesses lodge their personal income tax returns
 - businesses lodge schedules of their international transactions as appropriate
 - capital disposals, such as property and business sales, are reported properly for capital gains tax purposes, and
 - businesses that make cars available for their employees' private use report fringe benefits tax correctly.

Continuing priorities

In 2006–07 we are continuing to focus on:

- helping smaller businesses and their advisers comply with their tax obligations, particularly for infrequent or complex transactions, and reduce their compliance costs
- monitoring individuals' use of business assets and cash, particularly shareholder loans
- identifying emerging risks earlier to provide more certainty for business
- allowing businesses using service trust arrangements a period of 12 months to review these arrangements, and identifying cases where fees are inflated to shift profits
- checking that superannuation funds, including self managed superannuation funds, are fully complying with lodgment obligations, including lodging on time
- identifying and taking action against businesses that claim false or unsubstantiated input tax credits and/or fail to report large amounts of GST
- targeting businesses and associated individuals that have transactions with tax havens or are involved in international tax schemes
- checking the tax performance of businesses that persistently report losses, and
- following up auditor contravention reports for self managed superannuation funds.

REGISTERING IN THE SYSTEM

To ensure that small to medium enterprises participate fully in the tax system, we compare information from external sources, such as government organisations and financial institutions, with the information businesses provide to us (see the 'Employers and other intermediaries' chapter).

This year we are continuing to focus on registration compliance among entities:

- in industries that are active in the cash economy, such as building and construction, and used motor vehicle wholesaling
- associated with high-wealth individuals, and
- associated with aggressive tax planning arrangements.

MEETING LODGMENT OBLIGATIONS

Small to medium enterprises contribute a significant amount of revenue, and pose a potentially high risk if they fail to lodge.

To improve compliance, this year we are focusing on:

- pursuing outstanding lodgments from small to medium enterprises with an annual turnover of over \$10 million, both when they are profitable and when they are running at a loss
- ensuring that individuals who control small to medium enterprises are meeting their personal lodgment obligations
- following up high-wealth individuals who have not lodged the expected returns, or have not provided all the information required, and
- checking that superannuation funds, including self managed funds, fully comply with their lodgment obligations.

REPORTING CORRECT INFORMATION

High-wealth individuals

We are monitoring the compliance of around 1,000 high-wealth individuals, including:

- 900 people who each control net wealth of \$30 million or more, and
- 100 people who each control net wealth close to \$30 million or control high-value assets and have high profiles in the wider community.

In particular, we are focusing on arrangements that suggest aggressive tax planning, such as arrangements that seek to limit the amount of capital gains tax payable, and transactions conducted, or property held, offshore in low-tax jurisdictions.

Income tax reviews and audits

This year we expect to conduct 780 income tax reviews and 830 audits of small to medium enterprises focusing on:

- losses
- capital gains tax
- capital management
- service trusts
- phoenix arrangements, and
- the property building and construction industry.

The specific issues to be addressed by this activity are outlined in the following sections.

We also expect to contact 6,500 small to medium enterprises regarding high-risk income tax refunds. Another 900 businesses will be asked to explain unusual PAYG payment patterns. Where necessary, our enquiries will be escalated into more rigorous reviews or audits.

Losses

We are continuing to review the large number of small to medium enterprises that generate and recoup losses as we work to identify non-compliant practices such as:

- claiming inappropriate and inflated deductions
- under-reporting income
- profit-shifting
- recouping losses but not taking into account changed ownership or the fact that a different business is being conducted
- misclassifying losses as capital or revenue
- using loss arrangements to minimise tax, where the origin of the losses is artificial and has no economic or legal basis
- attempting to use related-party losses outside of the consolidation regime, and
- creating losses by incorrectly using the consolidation cost setting rules, or otherwise incorrectly applying the consolidation loss rules.

In particular, we are focusing on arrangements that suggest aggressive tax planning, such as arrangements that seek to limit the amount of capital gains tax payable, and transactions conducted, or property held, offshore in low-tax jurisdictions.

We are improving our capability and processes so that we can complete these reviews within new time limits provided by the law.

Capital gains tax

This year we are working to improve compliance by conducting reviews and, where necessary, audits to identify small to medium enterprises that are deliberately manipulating their business affairs to minimise a capital gain or obtain a capital gains tax concession.

This year our reviews are focusing on businesses that are:

- setting up arrangements to reduce their capital gain when the business is sold
- claiming small business concessions when they do not satisfy the threshold requirements
- failing to report capital gains tax events
- using significant capital losses to offset capital gains, and/or
- resetting the cost base of assets under consolidation, particularly where there have been significant capital gains or losses.

Capital management

We are continuing to monitor loans, payments and debts forgiven by private companies that in effect distribute company profits to shareholders (and their associates) in a non-taxable form. We are also focusing on aggressive tax planning involving corporate limited partnerships and unpaid present entitlements.

Capital management activities such as share buy-backs and capital reductions are becoming increasingly common in this market. Our reviews in 2005–06 highlighted that these activities pose a risk to compliance. This year we will continue to assess these arrangements with a specific focus on:

- the source of funds (retained profits or contributed equity) used to finance the buy-back or capital reduction
- whether the amount/s received by affected shareholders is correctly treated as dividends and/or a return of contributed equity (formerly referred to as share capital), and
- whether the amount paid by the company for each share reflects the market value of the share.

Service trusts

We are educating and helping small to medium enterprises that use service trust arrangements to ensure they understand and comply with their obligations under the law.

These obligations were explained in a ruling and companion guide we released in April 2006. Both publications reflect extensive consultation with representatives of the accounting, legal and medical professions.

Most professionals who use service arrangements will have until 30 April 2007 to review them in the light of our guidance. If their arrangement generally conforms to our guidance by then, there will be little risk of an audit.

We are also reviewing service trust arrangements where:

- service fees paid are more than \$1 million and represent over 50% of the gross fees of the business, and
- the net profit of the service entity represents over 50% of the total net profit of the business.

We also review cases where we believe the services may not have been provided by the service entity.

Phoenix arrangements

'Phoenix arrangements' are arrangements to evade tax through the deliberate, systematic and sometimes cyclic liquidation of related corporate trading entities. These arrangements continue to pose a significant risk to the tax system.

This year we are focusing on labour-intensive industries, and on compliance with PAYG withholding and GST obligations. We cooperate with external stakeholders, including the Australian Securities and Investments Commission and law enforcement agencies, to investigate and prosecute criminal activities.

For more information, see the 'Aggressive tax planning' chapter.

We are educating and helping small to medium enterprises that use service trust arrangements to ensure they understand and comply with their obligations under the law.

Property, building and construction industry

This year we will focus on property, building and construction businesses, especially where the business is part of a wholly privately owned group. We are doing this because there is a poor track record of compliance among these small to medium enterprises.

In particular, we are focusing on property developers who:

- claim excessive deductions to reduce profits
- make sales to associates at less than market value
- incorrectly categorise real property, in the form of trading stock, as investment capital for capital gains tax purposes, and
- do not comply with their GST obligations (see 'Goods and services tax' in the next column).

International tax issues

We are working to improve compliance by educating and helping small to medium enterprises understand and comply with their international tax obligations. We are also continuing to check that businesses are:

- properly declaring foreign source income
- accurately reporting international transactions by lodging appropriate schedules with their returns
- claiming only legitimate expenses relating to overseas transactions, and
- maintaining appropriate systems to detect international facilitation payments so that deductions for expenses and input tax credits are properly claimed.

We will focus on the profit shifting arrangements of small to medium enterprises by examining more sophisticated transfer pricing issues, including issues related to royalty payments, patents, trademarks, rights and management fees. We will conduct 20 reviews, finalise 15 audits and commence five audits focusing on profit shifting arrangements. We also expect to enter into eight advance pricing arrangements with small to medium enterprises.

We are also more actively pursuing onshore promoters, intermediaries and their associates who market or support tax haven schemes.

For more information, see the 'International tax issues' chapter.

Employer obligations

This year we will review around 440 cases where information reported against various employment obligations is inconsistent, for example:

- where amounts claimed as credits by employees in their tax returns do not match the amounts reported by employers, or
- where an employer is registered under a workers' compensation scheme but is not registered for PAYG withholding.

Of the 440 reviews mentioned above, around 300 include fringe benefits tax checks. In addition, we will also undertake specific reviews or audits of at least 20 employers that we

believe are at greatest risk of not complying with their fringe benefits tax obligations. We will also review around 3,000 PAYG withholding cases where we find discrepancies between activity statements and payment summary statements.

We are improving compliance with superannuation obligations by:

- following up all employees' claims that their employers have not offered them choice of superannuation fund or are not making superannuation payments on their behalf, and
- auditing employers identified as being at high risk of not complying.

We will conduct a study of employers whose behaviour indicates non-compliance with superannuation guarantee or choice obligations. The purpose of the study is twofold – to get a better understanding of reasons for non-compliance and to develop strategies to encourage future compliance.

Goods and services tax

To improve GST compliance, this year we will:

- review businesses whose GST management practices have failed to keep pace with their growth
- check that public share floats and real property transactions have been properly reported, and
- investigate small to medium enterprises that appear to have under-reported GST or over-claimed input tax credits.

Our work with small to medium enterprises that have grown rapidly over the past 12 months and have income of more than \$20 million shows that, in many cases, their internal GST controls and systems have not kept pace with their growth. We intend to mail questionnaires to 1,200 of these businesses. By analysing the responses, we will select 200 high-risk entities for audit. We may pay particular attention to those that do not respond to the questionnaire.

Infrequent and complex transactions such as financial supplies are often not reported correctly for GST purposes, particularly when an entity undertakes a public share float for the first time. This year we will review reporting by 50 small to medium enterprises which floated public shares on the Australian Stock Exchange in 2004–05.

We will also conduct reviews and audits of 350 small to medium enterprises that deal with real property. The reviews will examine non-compliance with GST obligations in areas such as sales, professional valuations and calculating change in the extent of creditable purpose.

If we are concerned about a refund, we telephone or visit the business to ask them to substantiate the claim. We may also contact third-party suppliers to validate transactions. This year we will check around 19,000 refund claims.

We continue to work with small to medium enterprises to ensure they record their GST and input tax credits correctly and this year will investigate some businesses

to determine whether they are calculating GST correctly. An example of incorrect reporting is recording GST as 0.1% rather than 10%.

Cash economy participation

This year we will review and audit around 800 businesses in high-risk industries, including:

- businesses in the building and construction industry
- licensed hotels and registered clubs, and
- businesses related to horse racing or fishing.

While we focus on non-compliance by businesses, we also try to verify that the accumulated wealth and lifestyle of the individual business owner are consistent with their reported income level. We also cooperate with other government organisations such as Centrelink to identify taxpayers who do not comply with their other reporting obligations.

Aggressive tax planning

We continue to compare information provided by small to medium enterprises with information from other sources and, in our analysis of trends and 'normal' compliance practice, look for evidence of aggressive tax planning practices.

In particular, we are focusing on:

- schemes to avoid tax through the artificial use of corporate limited partnerships or artificial trust and partnership arrangements
- schemes to avoid the operation of the shareholder loans provisions
- employee benefit arrangements designed to obtain benefits not intended by the law
- property arrangements designed to avoid or reduce GST, and
- arrangements involving the creation of input tax credits through the acquisition of assets of a debt-ridden entity by a related party.

For more information, see the 'Aggressive tax planning' chapter.

Superannuation funds

This year our activities to improve compliance by superannuation funds include:

- auditing self managed superannuation funds for income tax and regulatory compliance, and
- auditing a number of funds regulated by the Australian Prudential Regulation Authority to verify the accuracy and completeness of their reports and statements, including lost member reports and member contributions statements.

We are also examining the links between self managed funds and other related entities. Where we have questions about small to medium enterprises meeting their tax obligations, we will examine whether the related individual is managing their self managed fund correctly and meeting its superannuation, income tax and regulatory obligations.

Excise

We are providing information and assistance to ensure that small to medium enterprises understand their entitlements and obligations, including record keeping requirements, under the fuel tax credits system. This system substantially replaces the energy grants credits scheme from 1 July 2006.

This year we are increasing our activities to educate wine growers and help them understand and comply with their tax obligations, in particular, to minimise the misclassification of excisable goods as wine equalisation tax products.

MEETING PAYMENT OBLIGATIONS

Generally, small to medium enterprises have a good record of paying their tax on time.

Around 75% of the debt among small to medium enterprises is shared by 2,400 businesses (2.5% of the total number of businesses with debt), which each have a tax debt of more than \$100,000. Debt owed by small to medium enterprises is growing at a rate similar to the growth in overall debt in all segments.

If a small to medium enterprise fails to pay by the due date, we write to them or telephone them about the outstanding amount. If it is a new debt, we may write to them more than once, explaining their obligations and encouraging them to make a payment arrangement with us, such as through instalments.

If a business fails to respond to these letters, or fails to comply with an agreed payment arrangement, we take fair but firm action to recover the debt.

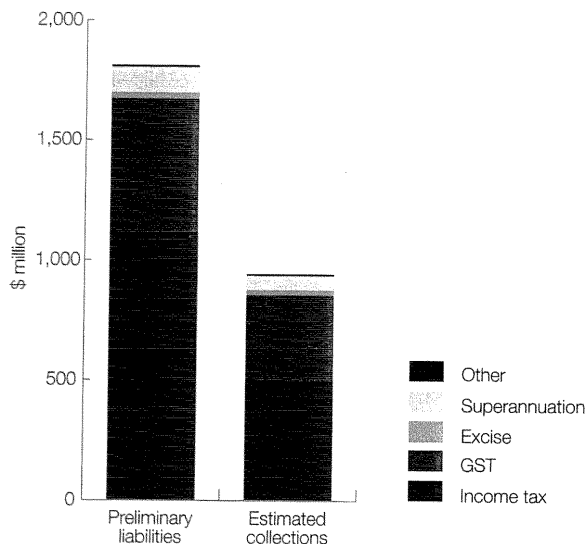
We monitor businesses that persistently remain in or fall into debt, and take fair but firm action if they fail to take up an opportunity to clear their debts. If necessary, we instigate bankruptcy or insolvency action.

COMMISSIONER'S ADVICE

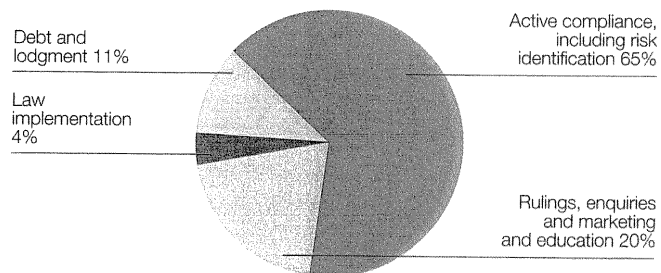
- If you have mistakenly provided us with any incomplete or inaccurate information, voluntarily disclosing this information leads to significantly reduced penalties.
- You can receive personalised advice to help you understand and comply with your business obligations by calling **13 28 66**, 8.00am to 6.00pm, Monday to Friday, to arrange an advisory visit.
- You can find information specifically for small to medium enterprises at www.ato.gov.au/business
- If you have any problems meeting your obligations – including lodging your activity statement or paying your tax on time – you can telephone us on **13 28 66**, 8.00am to 6.00pm, Monday to Friday, to discuss your situation.

PRELIMINARY RESULTS FOR 2005–06

Preliminary liabilities and estimated collections 2005–06^{1,2}



Preliminary small to medium enterprises segment expenditure 2005–06



1 Results include activities undertaken to prevent the issue of incorrect refunds or payments. For 2006–07, we are examining how we may separate pre-issue active compliance activities.

2 Commencing 2005–06, lodgment enforcement is included in our compliance activities.

Highlights of key activities

Income tax

- 1,200 income tax reviews and 1,000 audits conducted, raising \$356 million in tax and penalties. These results are made up of the following activities.
 - 300 reviews and audits of business losses finalised, resulting in \$328 million in current year and/or carried forward losses being disallowed.
 - Finalised 200 targeted reviews and audits focusing largely on small business capital gains tax concession calculations arising from business restructures, shifts in assets with no capital gain declared, and trust distributions.
 - 40 risk reviews and 9 audits involving transfer pricing finalised. A further 17 transfer pricing audits are in progress. We entered into 8 advance pricing arrangements with small to medium enterprises and have another 5 in progress.
 - 60 risk reviews involving tax havens finalised.
 - 150 phoenix audits finalised.
 - 460 audits and reviews of cases within the building and construction industry finalised, including 50 phoenix audits and 28 employer obligation audits.

- 9,100 income tax and fringe benefit tax returns and 14,500 activity statements cases finalised through targeted lodgment enforcement action, raising liabilities of \$296.4 million. In addition, 380 cases were subject to prosecution.
- Income tax returns – 8,200 income returns checked for excessive refund claims, with \$6.4 million in revenue protected.
- Employer obligations – 960 reviews and audits for compliance with PAYG withholding, superannuation guarantee and fringe benefits tax obligations, raising revenue of \$62.3 million. There were also 6,000 PAYG withholding liability integrity reviews conducted that focused on discrepancies between employers' payment summaries and their activity statements. These reviews raised \$45.8 million in liabilities.

Superannuation

- 4,100 employee complaint and referral cases actioned in relation to employers' superannuation guarantee obligations, resulting in more than 1,400 assessments being issued to employers, raising \$107.9 million in revenue.
- All employers advised of legislative changes to their superannuation obligations.

GST

- 300 property building reviews conducted, focusing on GST compliance, resulting in liabilities of \$47.3 million.
- 17,170 GST refund cases checked, raising GST liabilities of \$133.4 million.
- 120 cases involving fraudulent activity investigated, raising total liabilities of \$55.8 million.
- 1,060 reviews of small to medium enterprises involved in cash economy industries undertaken, resulting in additional total revenue of \$41.9 million. 6 of these cases were small to medium enterprises with a turnover of between \$50 and \$100 million and resulted in \$1.7 million additional revenue.
- 1,900 letters sent to small to medium enterprises advising them of their need to comply with certain tax obligations, such as reporting the disposal of an asset, resulting in GST liabilities of around \$900,000.
- 1,430 reviews of importers who participated in the deferred GST scheme conducted, resulting in \$12.5 million GST liabilities raised.
- 17 reviews of foreign tour operators completed, raising over \$690,000. We originally intended to undertake 30 reviews but due to a combination of education, working with the industry and active compliance activities, the risks were mitigated, allowing resources to be diverted to other risks.
- 28 cases involving GST aggressive tax planning arrangements completed, raising \$10.9 million.

Excise and fuel schemes

- In the lead up to the introduction of fuel tax credits, we carefully monitored the energy grants credits scheme to ensure that payments were accurate. In total, we reviewed 4,000 claims and found 660 warranted further investigation.
- Advised all concessional alcohol taxpayers of changes to the excise regime as a result of excise tariff reform while ensuring that they are complying with permit obligations in their production and use of concessional alcohol products.

Large businesses

REVENUE CONTRIBUTION

The tax paid by large businesses makes up around 36% of the total tax we collect.

Of the various taxes we collect, large businesses contribute:

- 66% of all income tax from companies
- 38% of all other income tax*
- 59% of all goods and services tax
- 78% of all wine equalisation tax and luxury car tax
- 55% of all fringe benefits tax, and
- 99% of all excise.

On behalf of their employees, large businesses also contribute a further 16% of total tax collected, through the amounts they withhold from payments to their employees.

* Other income tax includes collections from individuals from pay as you go instalments, debits on assessments, superannuation funds, superannuation surcharge, petroleum resource rent tax and refunds to individuals.

PROFILE

There are about 1,900 large businesses – business groups with an annual turnover around \$100 million or more – in Australia, collectively employing approximately 3 million people during the year. Of these, about 66% are Australian-owned and around 60% are public companies.

Most large businesses operate in the global marketplace but are mainly regulated and taxed at the national level. The complexity of these businesses creates challenges both for their own governance and for the revenue authorities and other regulatory agencies that deal with them.

Large businesses generally have access to tax management expertise, but their need for certainty sometimes prompts them to seek advice from us before undertaking major transactions. This is especially the case for transactions affected by new laws, even though the tax laws (the shortfall penalty regime and the new shortfall interest charge) mitigate the downside risks for them where they take reasonable care and have a reasonably arguable position.

Large businesses generally comply with procedural obligations, such as registration, lodgment and payment. Non-compliance typically occurs in two key areas.

- **Record keeping** – some large businesses fail to maintain adequate compliance systems.

- **Reporting information and claiming entitlements** – some large businesses make errors or take contentious positions, particularly in matters relating to tax structuring, valuations, transfer pricing studies and calculations used to give effect to major transactions or events.

OUR GENERAL APPROACH

Our approach to maximising compliance among large businesses is based on:

- ensuring they have the information and support they need to comply with their tax obligations
- profiling all large businesses to identify trends and particular business groups that are at high risk of not complying
- risk reviewing and auditing businesses with a high-risk profile, and
- closely monitoring business activities.

We advise and help large businesses to clarify complex areas of the law and make their reporting as streamlined as possible.

We continue to liaise with large businesses on complex areas of the legislation, particularly where this involves establishing a technical position. We act on our view of the law (explained in public rulings) to ensure a level playing field for all businesses.

We also bring to the attention of companies situations where they have made an error adverse to them.

We use a wide range of information, including information supplied by other government organisations (see the 'Employers and other intermediaries' chapter), to profile large businesses. We compare their business performance with their tax outcomes to identify:

- across-the-board patterns, trends and risks, and
- specific cases where tax outcomes seem inconsistent with business performance.

Because non-compliance in this segment could pose a significant risk to revenue, we closely monitor large business activities, for example:

- where very large transactions or transactions involving tax havens occur
- when profit outcomes or accounting changes are announced, and
- when tax instalments are paid.

We monitor payments against expected economic outcomes for each business sector, and contact businesses promptly if they fail to meet registration, lodgment or payment deadlines.

This intensive monitoring is complemented by our active compliance work. In relation to income tax, around 75 significant audits will be underway in 2006–07.

Where we find large businesses engaging in high-risk tax practices, they will be risk reviewed or audited. In some cases, we also identify related entities and expand our investigations to profile the tax performance of the group as a whole.

HEADLINE ISSUES

Each year we revise our compliance focus to treat new, emerging and existing risks.

New and expanded priorities

In 2006–07 we are placing more emphasis on:

- developing a better and more cooperative relationship with large businesses, including better lines of communication
- concluding a number of large disputes under the mutual agreement provisions of Australia's double tax treaties
- reviewing losses to determine whether they have been correctly incurred and deducted
- reviewing significant acquisitions and divestments, especially the tax outcomes of private equity investment groups, infrastructure groups and financial intermediaries to businesses conducting significant acquisition or divestment transactions
- reviewing the tax treatment of:
 - financial products such as hybrid securities, and
 - transfers of taxable contributions from superannuation funds to other financial entities
- reviewing businesses, particularly foreign-owned businesses, that had significant decreases in effective tax rates in 2005–06
- scrutinising business restructuring where corporate group functions, assets and risks are relocated to offshore related parties, including offshore marketing hubs
- checking that businesses have appropriate systems in place to detect international facilitation payments, so that deductions for expenses and input tax credits are properly claimed
- improving our capability and processes for dealing with large businesses and their representatives, including our understanding of the business context
- aiming to complete audit cases within two years, while achieving fair, sustainable outcomes that align with the intent of the law, and
- reviewing changes in capital management and their impact on consolidated group tax outcomes, especially given recent changes resulting from the introduction of the Australian equivalent of International Financial Reporting Standards.

Continuing priorities

In 2006–07 we are continuing to focus on:

- helping large businesses anticipate tax risks, and providing them with more certainty through public rulings and priority private rulings and piloting forward compliance arrangements
- helping large businesses comply with new tax measures and then monitoring their compliance with these measures
- ensuring that increased profits, particularly in the mining and resource and banking sectors, are translating into appropriate tax outcomes
- ensuring that corporate restructures and major transactions are treated correctly for capital gains tax purposes
- scrutinising businesses that have tax haven dealings or significant international related-party dealings and low tax outcomes, and
- monitoring and responding to risks raised by inadequate goods and services tax (GST) compliance systems.

REGISTERING IN THE SYSTEM

We monitor consolidated groups to ensure that all eligible entities fall within a single income tax registration. We also look for entities that are wrongly registered for GST in order to claim input tax credits.

MEETING LODGMENT OBLIGATIONS

Most large businesses comply with their lodgment obligations. However, some fail to lodge on time, or meet only part of their obligations – for example, by lodging activity statements but not lodging returns and schedules.

To improve compliance this year, we are focusing on:

- identifying and contacting large businesses that fail to lodge on time
- checking that large businesses with excise obligations are meeting their lodgment obligations
- ensuring that all taxpayers in large business groups have met all their lodgment obligations before and after their entry into a consolidated group, and
- checking that superannuation funds fully comply with their lodgment obligations, especially lodging timely and complete member contributions statements, lost member reports and departing Australia superannuation payment reports.

REPORTING CORRECT INFORMATION

Reviews and audits

We are building a new approach to conducting reviews and audits of large businesses. The new approach, which emphasises case management and dialogue, reflects the findings of an independent report on corporate taxpayer perceptions of our processes, and consultations with the large business community.

The main features of our new approach are:

- consultation – we will offer to regularly meet with representatives of the top 100 corporate groups, and host a large business symposium
- reviews – before finalising a risk review, we will advise the business of the preliminary findings and invite them to respond
- audits – we will explain the scope, process and possible implications of each audit, and ensure that audits are managed appropriately and finalised as quickly as possible

- technical issues – technical specialists will be engaged at an early stage when resolving major issues arising in an audit (where appropriate, businesses may be involved in these discussions), and
- rulings and forward compliance arrangements – we will work with representative bodies to prioritise industry issues for public rulings; continue to deliver timely private rulings, particularly on major transactions; and pilot forward compliance arrangements.

Tax and financial reporting reforms

We are continuing to review tax consolidation cases involving significant uplifts in asset values. To ensure that the tax outcomes are appropriate, we:

- check the calculation of the cost base of assets, and
- check the integrity of the recognition of new assets when consolidated groups are formed and when changes occur in the membership of consolidated groups.

In particular, we look at intellectual property assets, such as copyright, mining information and management rights. We also check the tax consolidation treatment of derivatives and financial products more generally.

To ensure compliance in transactions that occur between related taxpayers in corporate economic groups, we examine the:

- claimed deductions
- application of integrity measures, such as debt forgiveness, and
- tax outcomes.

We continue to check for consolidation capital gains tax events, and calculations, valuations or arrangements that lead to reductions in capital gains or generate significant capital losses. We aim to ensure that the general value shifting rules are applied appropriately.

In accordance with the introduction of the Australian equivalent of the International Financial Reporting Standards in 2005, in appropriate cases we will check the recognition and measurement of income and expenses for tax purposes, and the thin capitalisation and consolidation calculations that are based on the new standards.

We are also checking claims for significant 'blackhole expenditure' deductions based on the new rules introduced in 2005–06.

We are building a new approach to conducting reviews and audits of large businesses.

Acquisitions and divestments

We continue to scrutinise corporate acquisitions and divestments. In particular, we check that:

- debt funding, group structuring, loss calculations, asset values and capital gains tax outcomes are appropriate
- arm's-length pricing arrangements are put in place when foreign-owned groups acquire new businesses
- the income earned by financial intermediaries when working on acquisitions and divestments that should be taxed in Australia is being recognised and taxed appropriately, and
- private equity investment group and infrastructure group tax outcomes are appropriate.

Internal restructures

We continue to review or audit cases where internal restructures have resulted in lower tax outcomes or capital gains tax outcomes that appear to be at odds with the intent of the law.

We are also reviewing cross-jurisdictional restructures that reduce exposure to withholding taxes, such as deferred subscription arrangements and arrangements involving tax treaty interpretations that ultimately convert dividend, interest or royalty flows to business profits.

Losses

This year we are reviewing high-risk cases where businesses have declared losses, checking the:

- validity of losses being carried forward
- origin of losses generated, and
- origin of losses transferred into consolidated groups.

We are improving our capability and processes so that we can conduct these reviews within new time limits provided by law.

We review large businesses that persistently record losses, to ensure that their claims are justified and they are paying the correct amount of income tax, fringe benefits tax, excise and GST. We also look for reporting errors in:

- meeting the loss recoupment and deductibility tests
- correctly recognising income and expenses on capital and revenue accounts, and
- groups with current and prior year losses that have not consolidated.

Capital management

We are monitoring the use of financial products, such as hybrid securities, stapled securities and convertible notes, to ensure that the debt and equity rules are being properly applied and tax obligations are being met.

We also scrutinise changes in capital management and their impact on consolidated group tax outcomes especially given recent changes resulting from the introduction of the Australian equivalent of International Financial Reporting Standards.

Income and deductions

We are paying close attention to significant adjustments made to income and expenses, particularly in cases where profits are significantly reduced by tax reconciliation adjustments. Our aim is to ensure that:

- items of income are not improperly deferred or claimed as capital items, and
- items of capital expenditure are not claimed as revenue deductions.

We will also review large deductions for research and development, particularly in the banking and mining sectors.

Foreign exchange gains and losses

We are scrutinising foreign exchange transactions to ensure that:

- the rules for gains and losses have been complied with
- the quantum of the gain or loss is appropriate, and
- Australian entities have not incurred foreign exchange losses that should have been incurred offshore by related parties.

Bribes and facilitation payments

To ensure that only legitimate expenses are claimed as deductions and legitimate input tax credits are claimed, this year we are:

- reviewing significant, one-off, regular or embedded payments by Australian businesses to entities in jurisdictions where bribes or facilitation payments are said to be 'part of doing business'
- checking that businesses with particular international trade profiles have appropriate codes of conduct and systems in place to detect bribes and international facilitation payments, and
- reviewing organisations that do not have appropriate systems in place.

We continue to scrutinise corporate acquisitions and divestments.

Capital gains tax

We are working to ensure that economic gains are reflected in taxable gains as appropriate. We examine capital gains tax issues arising from mergers, acquisitions, divestments and capital rearrangements. When non-resident businesses dispose of their Australian assets and make a capital gain, we take action, where possible, to collect the appropriate amount of tax on that gain before sale proceeds are sent offshore.

We investigate any tax arrangements that we believe may be designed to distort capital gains tax outcomes, such as:

- complex and changing offshore and onshore structures
- aggressive use of rollovers, and
- income re-characterisation and value extraction before the disposal or liquidation of entities.

We also check for incorrect or skewed valuations that affect capital gains tax outcomes. We focus on consolidation events and divestments of significant businesses and assets, including intangible assets.

International tax issues

We are reviewing a number of foreign-owned business groups to improve our understanding of the significant reduction in effective tax rates and decreased tax outcomes that some large businesses experienced in 2005–06.

We will also review and, where necessary, audit some large corporate groups that have substantial international related-party dealings and a history of low or no tax outcomes to check that arm's-length pricing arrangements are in place. In particular, we will check large fee payments such as guarantee fees paid to related parties offshore.

Where important intangible assets are transferred offshore to low-tax jurisdictions, we will examine:

- the capital gains tax outcomes of the transfer
- the pricing of any new related-party dealings resulting from the transfer, and
- significant financing arrangements entered into around the time of transfer.

Increasingly, large businesses are transferring functions such as marketing to specialist hubs in low-tax jurisdictions. We will check some of these arrangements to ensure they have appropriate arm's-length outcomes.

We will also check the transfer pricing methodologies used to price new related-party transactions with entities based in some of the growing economies in our region.

To improve compliance and our understanding of the use of tax havens and its impact on the Australian tax system, we are examining significant:

- payments that involve entities in tax havens, as reported by the Australian Transaction Reports and Analysis Centre (AUSTRAC)
- transactions that involve related parties in tax havens, as reported in returns and schedules, and
- restructures that involve tax haven entities.

We are also reviewing cross-border financing arrangements, checking that withholding obligations have been met, to identify financing arrangements that are structured to duplicate benefits or gain tax benefits not intended by the law.

On behalf of the Australian taxpayer we seek an appropriate and timely resolution of disputes with treaty parties under the mutual agreement procedure.

For more information, see the 'International tax issues' chapter.

Goods and services tax

Refund integrity

Many large businesses regularly claim large GST refunds. We continue to monitor these refunds and undertake pre- and post-issue verification to ensure that the correct amounts are claimed but seek to minimise impacts on taxpayers' cash flow in doing so.

Property and construction

We continue to look at claims that involve the use of the GST margin scheme to ensure that:

- valuations for the GST margin scheme are not excessive and comply with the law, and
- stamp duty, construction costs or other expenses are not used to inflate valuations for acquired property.

We will examine transactions to ensure GST has been properly accounted for under the GST adjustment provisions such as:

- adjustments for changes in creditable purpose, for example where a residential property built for sale is subsequently leased, and
- adjustments relating to the sale of a going concern and cessation of business.

GST aggressive tax planning

We will continue to counter newly identified schemes and maintain our strategy of publishing timely taxpayer alerts. We remain committed to identifying promoters of GST and other tax schemes, including profiling advisers and facilitators and using our powers to obtain client lists.

We also continue to encourage large businesses to seek our advice before making significant changes to their GST arrangements.

In particular, we are focusing on detecting aggressive tax planning arrangements designed to avoid or reduce GST payable (see the 'Aggressive tax planning' chapter), including:

- international arrangements, particularly where businesses restructure to artificially sever a connection with Australia
- financial supply arrangements designed to produce inflated input tax credit claims, and
- second-hand goods arrangements that seek to circumvent the intended operation of the law.

Financial supplies

Specific areas that will attract our attention this year are:

- supplies of services to associated entities at less than market value
- recovery of GST on costs relating to mergers and acquisitions, and
- recovery of GST using a fair and reasonable apportionment methodology.

Integrity of business systems

Some large businesses have failed to keep up to date their internal corporate governance processes and systems for GST. We continue to help large businesses address this deficiency.

During the course of our audits, we will pay attention to:

- transactions processed outside of the accounts payable or accounts receivable systems, classified incorrectly and not captured in GST control accounts
- incorrect GST formula defaults or GST codes
- failure to report GST control accounts for reconciliation with business activity statements
- failure to update GST capture and reporting systems when other business systems are changed
- inadequate exception reporting to detect process or system failure, and
- failure to recognise an adjustment event – for example, early payment discounts for customers.

Excise

From 1 July 2006 a new system of fuel tax credits, claimable through the business activity statement, substantially replaces the energy grants credits scheme. The new system significantly expands eligibility for fuel tax relief and introduces a new requirement for businesses claiming more than \$3 million a year to join the Greenhouse Challenge Plus Programme.

Our activities this year will include the provision of assistance and advice in relation to this matter as well as assurance reviews to verify that business systems and record keeping practices meet the requirements of the reform measures.

Superannuation funds

We continue to help large superannuation funds improve the timeliness, completeness and accuracy of their reporting, in particular by:

- checking that payments are properly reported for reasonable benefit limit purposes, and following up cases where reporting is not correct, and
- ensuring that all lodgment obligations are complied with, including member contributions statements and departing Australia superannuation payment reports.

We will continue to audit unfunded defined benefit schemes to ensure that these funds comply with their obligations in relation to individual surcharge debt accounts they hold for their members.

Employer obligations

This year we will review around 20 cases of inconsistent reporting by large employers.

We continue to monitor employers, and will undertake at least 10 reviews or audits of businesses specifically to ensure they are complying with their fringe benefits tax obligations.

We will conduct a study of employers whose behaviour indicates non-compliance with superannuation guarantee or choice obligations. The purpose of this study is twofold – to get a better understanding of reasons for non-compliance and to develop strategies to encourage future compliance. We will also follow up all employees' claims that their employers have not offered them choice of superannuation fund or are not making superannuation payments on their behalf.

MEETING PAYMENT OBLIGATIONS

Large businesses have a good record of making their tax payments on time.

We monitor all major payment obligations closely and quickly follow up any variation from expected payment patterns. For particularly large payments, we contact businesses in advance to confirm payment arrangements.

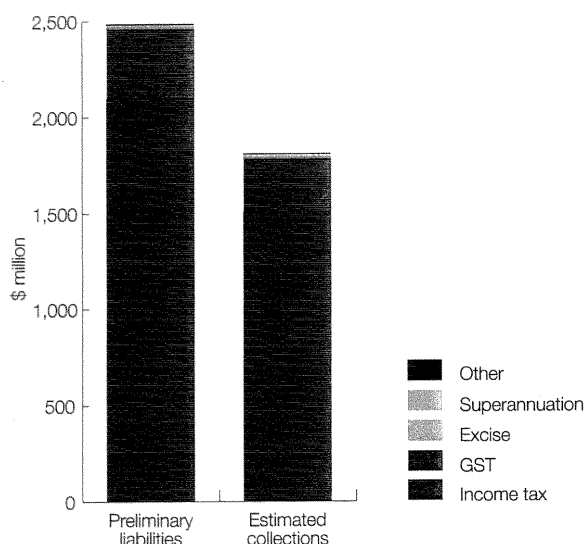
Where corporate groups have consolidated or are expected to consolidate, we enquire about quarterly tax payments, before and after the due dates, to identify and understand significant payment variations.

COMMISSIONER'S ADVICE

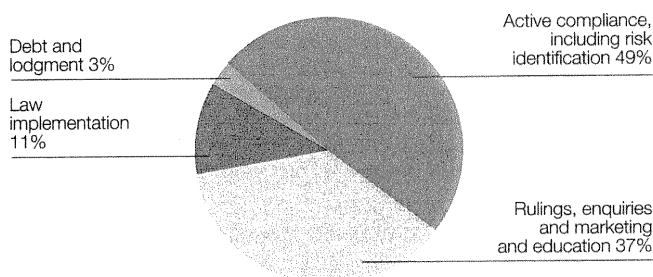
- If you require a priority ruling, you should contact us as soon as possible to ensure our response can be provided in a timeframe that meets your business needs.
- You can take advantage of our new consultative arrangements to help us understand your business and develop a good working relationship.
- To minimise your compliance risk you should check that:
 - any significant reconciliation adjustments between your accounting profit and taxable income are appropriate, and
 - your losses and capital gains tax interpretations, valuations, calculations and outcomes are appropriate.
- You can find information specifically for large businesses at www.ato.gov.au/large

PRELIMINARY RESULTS FOR 2005–06

Preliminary liabilities and estimated collections 2005–06^{1,2,3,4}



Preliminary large businesses segment expenditure 2005–06



- 1 Results include activities undertaken to prevent the issue of incorrect refunds or payments. For 2006–07, we are examining how we may separate pre-issue active compliance activities.
- 2 Commencing 2005–06, lodgment enforcement is included in our compliance activities.
- 3 Preliminary estimate of credit amendments arising from the resolution of disputes in 2005–06 in the large market is approximately \$596 million. These amendments generally relate to liabilities raised prior to 2005–06.
- 4 Of reported liabilities for 2005–06, the preliminary estimate indicates that \$1.3 billion is in dispute from the large market results. Of this, approximately \$1 billion is subject to objection and \$0.3 billion is subject to appeal/litigation.

Highlights of key activities¹

Income tax

- Over \$1.4 billion collected from risk reviews and audits.
- Around \$2 billion in new income tax liabilities raised from risk reviews and audits.
- Notional tax² over \$1.5 billion.
- Lodgment compliance – 2,300 income tax and FBT returns, and 4,500 activity statements finalised through targeted enforcement action, raising liabilities of \$82.1 million.
- Reduced the average time it takes us to provide written advice by 2 months and reduced the average age of stock on hand of that advice by 1 month.
- 250 requests for written binding advice finalised, including 30 requests for priority private binding rulings; and 70 class rulings, 20 product rulings and 55 public rulings issued to help taxpayers comply with the law, including new laws relating to consolidation.
- 480 objections resolved and 50 litigation cases involving complex compliance issues finalised.
- 280 fieldwork risk reviews completed, including 24 with a transfer pricing focus and 30 with a consolidation focus.

- A further 250 risk reviews were completed in relation to high wealth individual clients.
- 300 specific enquiries undertaken to understand trends in tax payments, emerging tax structuring and the tax outcomes of corporate events as they occurred. A further 16 were completed in relation to high wealth individuals.
- 55 compliance audits of large businesses completed and a further 35 audits of high wealth individuals. This work included finalising some older, more complex cases and starting new work to deal with other higher risk cases.
- 19 new advance pricing arrangements completed, giving corporate groups certainty in their future transfer pricing arrangements.
- 7 mutual agreement procedures conducted in relation to overseas transactions, with a further 10 underway. These procedures, which are initiated by taxpayers who claim to be in a double tax position, provide for a potential double tax situation to be discussed, examined and, where possible, resolved.
- We are continuing to build our relationships with, and present our view to, peak bodies, industries and tax professionals, with the aim of working together to improve compliance practices, processes and approaches. Surveys of taxpayers have indicated an increased satisfaction with the professionalism of our compliance staff.

1 Some assessments may be subject to disputes which may ultimately be resolved in favour of the taxpayer. We will cover this in our Annual report.

2 For the large business segment, notional tax includes income tax revenue impacts associated with the reduction of carried forward losses.

GST

Over \$350 million in GST liabilities has been raised through compliance activities in this market.

- 440 requests for written binding advice finalised.
- 11 public rulings, 4 draft public rulings, 6 GST determinations and 22 GST advices issued to help clients understand their GST obligations.
- 50 objections resolved and 12 significant litigation cases finalised.
- Over 1,350 compliance audits finalised. This includes audits in relation to the incorrect application of the margin scheme and integrity of business systems, which remain a significant focus area.
- Deferred GST – over 4,500 cases finalised.
- Over 4,500 reviews undertaken pre-issue to verify the correctness of refunds claimed.
- Other compliance activities – over 3,000 cases finalised.
- Undertook significant consultation with large market industry bodies and professional forums to implement strategies to reduce the cost of compliance.
- Implemented the large corporate compliance program review recommendations leading to improved practices and procedures.
- Clarified issues and negotiated with a number of taxpayers on forward compliance arrangements.

Excise

- Completed four major audits: one in each of the petroleum and tobacco industries and two in the alcohol and wine industry.

Superannuation

- 220 employee complaint cases actioned in relation to employers' superannuation guarantee obligations, with 70 cases raising \$13.5 million revenue.
- All employers were contacted to advise them about legislative changes to their superannuation obligations.

Non-profit organisations

REVENUE CONTRIBUTION

The tax paid by non-profit organisations makes up less than 1% of the total tax we collect.

Of the various taxes we collect, non-profit organisations contribute:

- less than 1% of all income tax from companies
- 3% of all goods and services tax, and
- 8% of all fringe benefits tax.

On behalf of their employees, non-profit organisations also contribute a further 3% of total tax collected, through the amounts they withhold from payments to their employees.

PROFILE

There are around 700,000¹ non-profit organisations in Australia, collectively employing more than 1 million people during the year. Non-profit organisations include charitable, religious and community service bodies; sporting and recreational clubs; business and professional associations and trade unions; private schools; some hospitals; and some large financial and insurance companies.

Around 188,000 of these organisations are registered with us. The remainder are not required to be registered because, for example, they have turnover or taxable income below a certain level, or are not required to be endorsed in order to benefit from tax concessions.

A range of tax concessions – such as exemption from income tax or fringe benefits tax, access to a fringe benefits tax rebate, or goods and services tax (GST) concessions – are available to non-profit organisations, subject to conditions. Charities and certain funds that are exempt from income tax must be endorsed by us to obtain certain tax concessions. Deductible gift recipients must also be endorsed by us to receive income tax deductible gifts. Other non-profit organisations can generally self-assess whether they are entitled to the concessions available to them.

¹ Lyons, M. 2001, *Third sector: the contribution of nonprofit and cooperative enterprises in Australia*, Allen & Unwin, Sydney, p.21.

Only around 22% of non-profit organisations have their returns prepared by tax agents.

Most non-profit organisations fully comply with their tax obligations. However, some compliance issues arise, mainly because many non-profit organisations have limited resources for managing their tax affairs and rely heavily on volunteers who have limited tax expertise. Compliance issues typically occur in five key areas.

- **Registering** – some non-profit organisations seek endorsement when they are not entitled, or change their activities in ways that affect their endorsement.
- **Keeping proper records** – many small non-profit organisations do not keep adequate records.
- **Lodging forms on time** – some non-profit organisations fail to meet some of their lodgment obligations, or fail to lodge on time.
- **Reporting correct information and claiming valid entitlements** – some non-profit organisations do not report their taxable income correctly, or do not properly meet their employer and GST obligations. A very small number of organisations attempt to exploit the concessions to get benefits they are not entitled to.
- **Paying tax on time** – some non-profit organisations have trouble paying their tax, often because of poor cash flow management and/or limited ability to raise funds.

OUR GENERAL APPROACH

Our approach to maximising compliance among non-profit organisations is primarily based on ensuring organisations have the information and support they need to comply with their tax obligations at minimal cost. We also:

- publish the tax status of organisations that are registered for tax concessions, and
- review organisations to ensure their activities correspond to their tax status.

In designing our information products and services, we consult representatives of non-profit organisations. We continue to build relationships with peak and industry bodies such as the Charities Consultative Committee, the Clubs Forum, the Health Industry Partnership and the Indigenous Tax Advisory Group. This collaboration also helps us to develop and deliver effective education programs.

Our targeted information products and services for non-profit organisations include:

- printed publications that cover a range of broad and specific issues – for example, *Tax basics for non-profit organisations*, *Non-profit organisations and fundraising* and *GiftPack for deductible gift recipients and donors*, and
- telephone enquiry services and internet information.

We publish details of endorsed deductible gift recipients and tax concession charities on the Australian Business Register website. This encourages compliance and means that prospective donors can check the tax status of particular organisations.

We monitor trends in the segment closely and alert organisations that are at high risk of not complying.

If organisations deliberately ignore their obligations or misuse concessions, we undertake audits and penalties may apply.

HEADLINE ISSUES

Each year we revise our compliance focus to treat new, emerging and existing risks.

New and expanded priorities

In 2006–07 we are placing more emphasis on:

- updating our systems and information products to reflect changes in tax laws
- developing an information package for Indigenous grant providers and recipients
- checking that taxable clubs and associations are correctly reporting non-member income
- identifying high-risk prescribed private funds, and conducting targeted compliance activities, and
- testing compliance with our view of the law explained in recently released Tax Office rulings on charities, and companies controlled by exempt entities.

Continuing priorities

In 2006–07 we are continuing to focus on:

- improving our information and support for non-profit organisations
- checking that closely held charities and income tax exempt entities are not obtaining tax benefits inappropriately
- scrutinising the activities of non-profit organisations that have links with aggressive tax scheme promoters
- reviewing the concession entitlements of endorsed charities that undertake commercial activities
- reviewing clubs and other non-profit associations that have assessed themselves as being income tax exempt
- testing the compliance of non-profit organisations that have registration requirements with us and other government organisations
- checking that employers comply with their pay as you go (PAYG) withholding, fringe benefits tax, reasonable benefit limit reporting, and superannuation obligations, and
- helping organisations to meet their GST obligations for non commercial transactions.

REGISTERING IN THE SYSTEM

We check all applications from organisations seeking endorsement to access tax concessions or to receive income tax deductible gifts to ensure that only those entitled to endorsement receive it. Where information on the application does not match the expected organisational profile, we conduct a review. This may involve contacting the organisation.

We expect to receive and check around 8,000 endorsement applications this year.

Each year we also review a number of endorsed non-profit organisations to check whether their activities have changed in ways that affect their concession entitlements.

We select cases for review by:

- analysing information from past compliance activities to identify specific risk areas
- comparing information provided by non-profit organisations with information supplied by third parties, such as the Australian Electoral Commission and the Australian Transaction Reports and Analysis Centre (AUSTRAC), and
- following up information supplied by the community.

In reviewing organisations that may be at risk, we consider:

- the nature of any activity that may affect the entity's endorsement
- whether gift fund accounts have been properly maintained
- whether administrative requirements such as non-profit clauses have been met, and
- whether applications for refunds of franking credits are correct.

This year we will review the integrity of around 80 endorsed organisations.

MEETING LODGMENT OBLIGATIONS

Most non-profit organisations comply with their lodgment obligations. However, some fail to lodge, fail to lodge on time, or meet only part of their obligations – for example, by lodging activity statements but not lodging income tax or fringe benefits tax returns.

To improve compliance, this year we are focusing on:

- using information from the community, business, other government organisations and our records to identify non-profit organisations that are not meeting their lodgment obligations
- monitoring organisations with significant turnover or high levels of tax payable, and
- assisting tax agents to help their clients meet their lodgment obligations.

REPORTING CORRECT INFORMATION

Non-member income of taxable non-profit clubs and associations

This year we will conduct specific reviews of around 45 taxable non-profit clubs and associations that report comparatively low levels of non-member income in their income tax returns.

Employer obligations

We are continuing to ensure that non-profit organisations meet their employer obligations, including applying the right tax treatment for their workers and making correct superannuation contributions on their behalf.

We will review cases where there is an unexplained difference between what we expect to be reported and what is reported, such as where:

- the amount of PAYG withholding an organisation has paid during the year is less than the total withheld amounts shown on its employees' payment summaries, or
- reporting under one employer obligation, such as WorkCover registrations, does not match reporting under another, such as PAYG withholding.

Where we identify discrepancies, we write to, telephone or visit the organisation to verify that it is complying with its reporting and payment obligations.

This year we will:

- conduct 130 reviews to ensure that organisations are complying with all their employer obligations, and
- follow up all employees' claims that their employers have not offered them choice of superannuation fund or are not making superannuation payments on their behalf.

We are also continuing to monitor for compliance the extensive use by non-profit organisations of the fringe benefits tax exemptions and rebate. We will conduct at least 20 reviews or audits of non-profit employers that are at risk of not meeting their fringe benefits tax obligations.

We check all applications from organisations seeking endorsement to access tax concessions or to receive income tax deductible gifts to ensure that only those entitled to endorsement receive it.

Goods and services tax

To improve GST compliance, this year we are focusing on educating and helping non-profit organisations to improve:

- record keeping practices
- accounting for GST for non-commercial supplies, and
- access to information for Indigenous organisations.

We provide education products to help non-profit organisations, which often have limited resources and expertise, to understand and comply with their record keeping responsibilities. This year we are continuing to:

- offer a mix of electronic, telephone, paper and face-to-face communication options
- improve our website, and
- raise awareness of our products and services.

We continue to develop strategies to improve organisations' understanding of the rules for accounting for GST for non-commercial supplies, such as accommodation and meals. To improve compliance and reduce costs, we are providing tools on our website to make it easier for organisations to determine when they should account for GST.

Indigenous organisations in remote locations often have limited access to our information and services. This year we will continue to conduct seminars in Indigenous communities to help them understand and comply with their GST obligations.

This year we will undertake at least 2,900 GST audits of compliance issues and refunds.

We select cases for review of GST compliance by:

- analysing our information (including tax returns, endorsement applications, Australian business number registrations and activity statements) to define 'normal' compliance behaviour, and then identifying organisations that do not fit that profile
- matching tax information with information from other sources to identify unreported supplies
- identifying organisations that rely largely on volunteers and/or have high turnover of personnel
- monitoring media coverage to identify issues of public concern and potential risk, and
- following up information supplied by the community.

Aggressive tax planning

To ensure that concessions for non-profit organisations are not exploited to avoid tax, we scrutinise the activities of:

- entities with the potential to use 'closely held' charities – that is, charities controlled by and closely integrated with one entity or a small number of entities – to obtain tax benefits they would not otherwise be entitled to, and
- tax scheme promoters who are involved with non-profit organisations.

This year we are particularly looking for:

- non-profit structures being used inappropriately to obtain tax benefits for individuals or their associated entities
- significant interrelated transactions between a non-profit entity and other associated entities controlled by the same people or directors, and
- significant fund movements and investments with financiers located in tax havens, or other inappropriate financial arrangements.

For more information, see the 'Aggressive tax planning' chapter.

Excise

We are working to ensure that non-profit organisations understand their entitlements and obligations under the new system of fuel tax credits, and keep appropriate records.

From 1 July 2006 fuel tax credits can be claimed through business activity statements. They substantially replace the energy grants credits scheme. The new system significantly expands eligibility for fuel tax relief in the non-profit segment.

MEETING PAYMENT OBLIGATIONS

If a non-profit organisation fails to pay by the due date, we write to or telephone them about the outstanding amount.

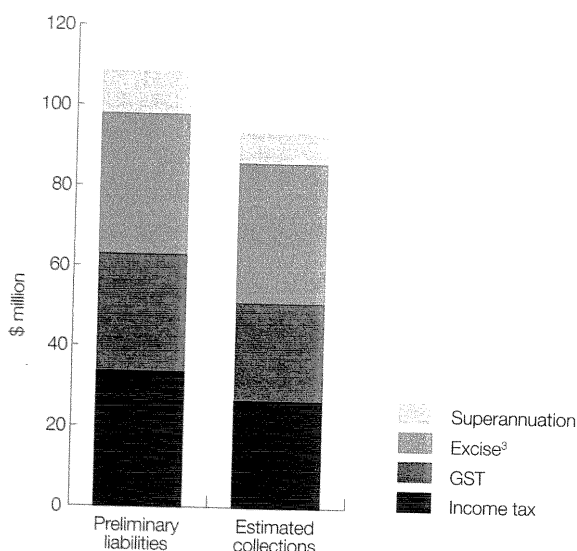
If an organisation has difficulty paying, we provide options such as payment by instalments. We also provide tools and advice to help them ensure that similar problems do not arise again.

COMMISSIONER'S ADVICE

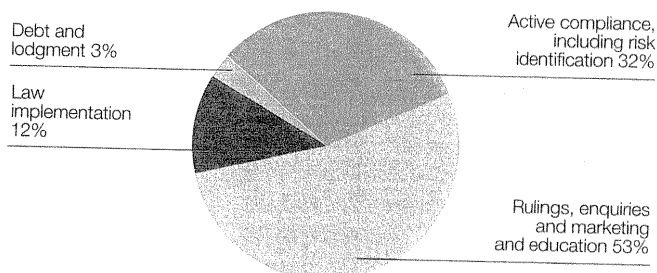
- Information on the requirements to be endorsed as a charity, possible exemptions or concessions, and other information specifically for non-profit organisations is at www.ato.gov.au/nonprofit
- You can subscribe to our *Non-Profit News Service* and receive email updates on key tax issues by selecting the 'Subscribe' link at www.ato.gov.au and ticking the 'Non-Profit Organisations' option.
- For direct access to people trained to deal with non-profit enquiries relating to charities, clubs, societies and associations, you can telephone us on **1300 130 248**, 8.00am to 6.00pm, Monday to Friday.

PRELIMINARY RESULTS FOR 2005–06

Preliminary liabilities and estimated collections 2005–06^{1,2}



Preliminary non-profit organisations segment expenditure 2005–06



- 1 Results include activities undertaken to prevent the issue of incorrect refunds or payments. For 2006–07, we are examining how we may separate pre-issue active compliance activities.
- 2 Commencing 2005–06, lodgment enforcement is included in our compliance activities.
- 3 This result is primarily due to one significant excise adjustment, which is unlikely to recur in future years. This adjustment related to the incorrect completion of the claim form by the taxpayer.

Highlights of key activities

Income tax

- Endorsement – 6,000 applications for endorsement as charities and deductible gift recipients checked and determined, with 1,400 disallowed.
- Income tax exempt status – 75 non-profit organisations (clubs and other associations) reviewed for compliance of their exempt status, resulting in 4 organisations losing their exempt status, with tax and penalties of \$147,000 assessed.
- Prescribed private fund endorsement – 40 reviews completed, resulting in their prescribed private fund status being maintained.
- Employer obligations – 27 reviews undertaken and 50 businesses audited for compliance with their PAYG withholding, superannuation guarantee and fringe benefits tax obligations, raising revenue of \$1.6 million. There were also 1,600 PAYG withholding liability integrity reviews conducted that focused on discrepancies between employers' payment summaries and their activity statements. These reviews raised \$7.9 million in liabilities.
- Refund of franking credits – 3,400 applications vetted, with 150 applications varied down, saving \$7.4 million in revenue.
- Income tax concessions – entitlements for 340 deductible gift recipients and tax concession charities reviewed in highly targeted compliance activities, with 190 entitlements revoked.

GST

- 9,800 GST compliance interventions completed, including 2,800 GST audits.

Superannuation

- 320 employee complaint cases actioned in relation to employers' superannuation guarantee obligations, with 190 cases raising \$11.5 million in revenue.
- All employers advised of legislative changes to their superannuation obligations.

Helping non-profit organisations comply

To provide further clarity to the community, we finalised 3 public rulings which explain what a charity is, what a gift is and the status of companies controlled by exempt organisations. These rulings had been previously released to the public as drafts, inviting them to provide comments. We also provided private advice on the charitable status of funds.

In response to a number of disasters, we provided a range of assistance to the people affected. We provided tax advice regarding the financial support made available by the Australian Government in the case of Cyclone Larry, contacted third parties to offer assistance with establishing charitable funds in the case of the Beaconsfield mine incident, and expedited the endorsement of a necessitous circumstances fund for those affected by the Gladstone refinery explosion.

Government organisations

REVENUE CONTRIBUTION

Overall, this segment receives a refund equal to around 3% of the total tax we collect – largely due to GST credits.

In general, GST paid by government organisations is refunded to them. Of the total net GST we collect, about 21% is refunded to government organisations.

Government organisations pay around 17% of the total fringe benefits tax we collect.

On behalf of their employees, government organisations contribute 9% of total tax collected, through the amounts they withhold from payments to their employees.

PROFILE

Collectively, the various levels of government in Australia comprise around 17,000 organisations, and employ more than 1.5 million people during the year. Government organisations have significant employer and goods and services tax (GST) obligations, but most are exempt from income tax and other taxes.

Government organisations recognise and seek to meet the community's expectation that they will comply with all their tax obligations. Most comply fully, particularly at the national and state and territory levels, where they are strongly supported by treasuries and finance departments. Non-compliance occurs more often among smaller government organisations that have limited resources for managing their tax obligations and/or have frequent staff changes.

Non-compliance occurs most often in situations involving unusual or complex transactions. Compliance in relation to pay as you go (PAYG) withholding is generally high, but some organisations fail to accurately distinguish between employees and contractors for tax purposes. Some organisations also have difficulty with fringe benefits tax and superannuation obligations.

The relatively frequent restructuring of organisations in the government segment can make it difficult for them to comply fully. However, the increasing emphasis on good governance and best practice provides them with opportunities to improve their compliance.

OUR GENERAL APPROACH

Our approach to maximising compliance among government organisations is based on ensuring that they have the information and support they need to correctly register, lodge their activity statements and returns, and meet their payment obligations.

Several general Tax Office publications cover topics relevant to the government segment. We also provide a number of tailored help and education products, including a superannuation guide for all Australian Government employers.

Over the past few years, we have worked closely with the Australian National Audit Office (ANAO) to develop the publications:

- *A better practice guide for management of GST administration, and*
- *Administration of fringe benefits tax – better practice guide.*

A section of our website is dedicated to providing information for government organisations.

We give practical advice about tax obligations to government organisations when requested, and work closely with treasuries and finance departments to promote good governance. We also help organisations such as local government associations adopt practices and systems that promote compliance.

Our compliance activities in this segment involve checking activity statements, including refunds, and undertaking specific-purpose audits.

HEADLINE ISSUES

Each year we revise our compliance focus to treat new, emerging and existing risks.

New and expanded priorities

In 2006–07 we are placing more emphasis on:

- ensuring that land and property transactions involving government organisations are treated correctly, particularly in relation to the GST status of the supply of land and the use of the margin scheme
- ensuring that GST refunds paid to government organisations are calculated correctly
- ensuring that employers comply with their choice of superannuation fund obligations
- improving our services, including website information and tools and guides
- encouraging government organisations to apply best tax practices that have previously been agreed and documented, and
- improving our understanding of the compliance challenges facing local government, and tailoring services for that sector.

Continuing priorities

In 2006–07 we are continuing to focus on:

- ensuring that transactions involving three or more parties, including where grants of financial assistance are involved, are treated correctly for GST purposes
- monitoring the GST implications of restructuring government departments
- checking that employers comply with their PAYG withholding, fringe benefits tax, reasonable benefit limit reporting, and superannuation obligations
- encouraging government organisations to invest in systems to better manage their tax obligations, and
- continuing to consult with government organisations to deliver effective education programs through mechanisms such as the:
 - GST Administration Sub-committee (GST Policy Group)
 - States and Territories Industry Partnership
 - Indigenous Tax Advisory Group
 - Education Industry Partnership
 - Health Industry Partnership, and
 - Australian Health Ministers' Advisory Council.

REGISTERING IN THE SYSTEM

Because government organisations have a good record of being registered with us, and non-compliance is rare in this segment, we do not routinely check the registration status of government organisations.

MEETING LODGMENT OBLIGATIONS

Government organisations are usually highly compliant in lodging returns for GST, fringe benefits tax and PAYG withholding. This year we are continuing to help organisations improve the timeliness of their returns.

REPORTING CORRECT INFORMATION

Employer obligations

To assure the community that organisations are complying, we are continuing to monitor organisations' compliance with their employer obligations. This includes checking that these organisations apply the right tax treatment for their workers and make correct superannuation contributions on their behalf.

We conduct a review where there is an unexplained difference between what we expect to be reported and what is reported – for example, where the amount of PAYG withholding an organisation has paid during the year is less than the total withheld amounts shown on its employees' payment summaries. We also write to, telephone or visit government organisations to verify that they are complying with their employer obligations.

This year we plan to:

- complete 10 audits, selected from reviews undertaken in 2005–06
- follow up all employees' claims that their employers have not offered them choice of superannuation fund or are not making superannuation payments on their behalf, and
- undertake at least 20 reviews or audits of employers that we believe are at risk of not meeting their fringe benefits tax obligations.

To assure the community that organisations are complying, we are continuing to monitor organisations' compliance with their employer obligations.

Goods and services tax

To improve GST compliance, this year we are helping government organisations evaluate and improve their business systems to ensure they are adequate to record transactions and generate activity statements, particularly where unusual transactions or large refunds are involved.

We also provide organisations with advice and education to ensure the correct treatment of:

- transactions involving property, where organisations need to ensure that their treatment of the GST status of the supply of the land and their use of the margin scheme are correct
- transactions involving three or more parties, including grants of financial assistance, where organisations need to ensure that the party making the supply is accounting for the GST payable and the party receiving the supply is claiming the GST credits, and
- organisational restructures, where organisations need to ensure that their systems and documentation are kept up to date for tax purposes.

We select cases for review of GST compliance by analysing information such as PAYG information, activity statements and organisations' annual reports to define 'normal' behaviour, and then identifying organisations that do not fit that profile.

We look for:

- larger than expected refund claims
- a high ratio of GST-free supplies to total supplies
- particular types of supplies (such as land sales)
- unexpected transactions (such as export sales), and
- variations in reported supplies and credits from one tax period to the next.

Our other strategies include:

- working with the organisations to identify potential problem areas
- matching our information with information from other sources to identify unreported supplies
- analysing private ruling requests to identify organisations with high-risk transactions
- monitoring media coverage to identify issues of public concern and areas of potential risk
- analysing information received from consultative arrangements, and
- following up complaints we receive.

This year we will undertake at least 1,000 GST audits of compliance issues and refunds.

Excise

We are working to ensure that government organisations understand their entitlements and obligations under the new system of fuel tax credits, and keep appropriate records.

From 1 July 2006 fuel tax credits can be claimed through business activity statements. This new system substantially replaces the energy grants credits scheme. It significantly expands eligibility for fuel tax relief in the government segment.

MEETING PAYMENT OBLIGATIONS

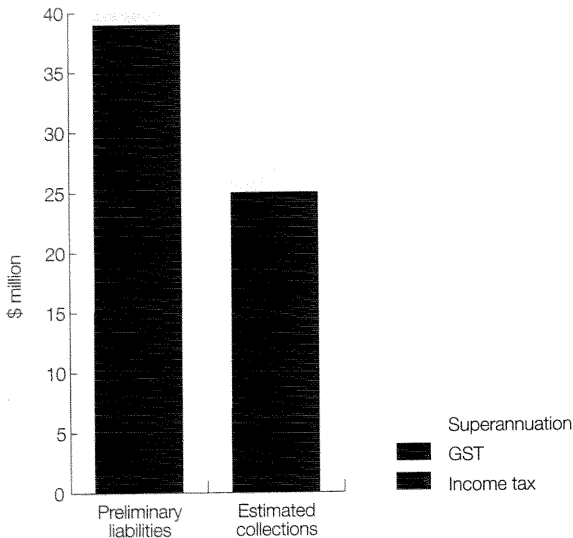
Government organisations generally pay their agreed liabilities. We expect a high level of payment compliance in this segment.

COMMISSIONER'S ADVICE

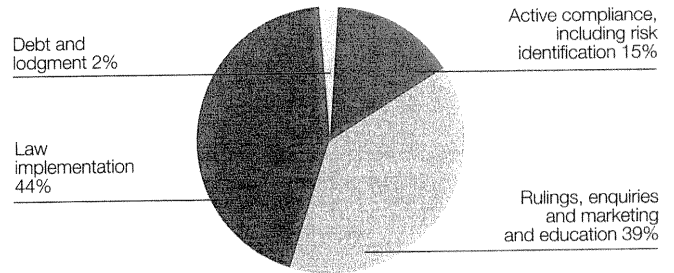
- You can find information specifically for government organisations at www.ato.gov.au/government
- For guidance on better practices for the administration of GST and fringe benefits tax, you can visit the Australian National Audit Office (ANAO) website at www.anao.gov.au to access and order:
 - *A better practice guide for management of GST administration*, and
 - *the Administration of fringe benefits tax – better practice guide*.
- To help you determine your eligibility for fuel tax credits, you can visit www.ato.gov.au/fuelschemes for fact sheets, worksheets and general information.

PRELIMINARY RESULTS FOR 2005–06

Preliminary liabilities and estimated collections 2005–06^{1,2}



Preliminary government organisations segment expenditure 2005–06



- 1 Results include activities undertaken to prevent the issue of incorrect refunds or payments. For 2006–07, we are examining how we may separate pre-issue active compliance activities.
- 2 Commencing 2005–06, lodgment enforcement is included in our compliance activities.

Highlights of key activities

Supported by our industry partners, we have been effective in explaining how the laws apply to various transactions in the government segment and in minimising compliance costs. Results from our compliance activities indicate very high levels of compliance in this segment.

Goods and services tax

- 2,500 GST compliance interventions completed, including 930 GST audits.

Superannuation

- 60 employee complaint cases actioned in relation to employers' superannuation guarantee obligations, with 14 cases raising \$1.2 million in revenue.
- All employers advised of legislative changes to their superannuation obligations.

Fringe benefits tax

- 3 cases completed raising \$11.1 million in revenue.

02

KEY ISSUES

INTERNATIONAL TAX ISSUES
AGGRESSIVE TAX PLANNING
SERIOUS EVASION AND FRAUD

There are a number of compliance issues that are common to two or more market segments.

This section outlines the key issues we are focusing on and what we are doing to address them.

International tax issues

PROFILE

Taxpayers across all segments of the Australian tax system are becoming increasingly involved in international business and investment, and more people are moving across national borders to live and work.

For example, around:

- 1 million Australians work overseas
- 500,000 foreign citizens work in Australia
- 40% of trade in goods and services crosses national borders
- 35% of investment crosses national borders
- \$700 billion is invested overseas by Australians
- \$1,300 billion is invested in Australia by foreign residents, and
- 50% of imports and 30% of exports involve international related-party transactions.

In addition, the number of e-commerce transactions continues to increase.

International tax issues therefore have a major impact on Australia.

International tax issues range from using tax differences between jurisdictions (called arbitrage), to simple errors caused by lack of awareness of international obligations, to evasion and fraud.

The growth of the global economy has been accompanied by improved cooperation between tax jurisdictions, and more effective data sharing and analysis.

OUR GENERAL APPROACH

Our approach to international tax issues involves:

- ensuring taxpayers have the information and support they need to comply with their international tax obligations
- collecting, exchanging and analysing information to identify practices and trends that pose a significant risk to compliance
- monitoring and, where necessary, reviewing compliance, and
- taking firm action where taxpayers deliberately or persistently fail to comply.

To provide taxpayers with certainty about the tax treatment of their affairs, we encourage them to seek our advice, and publish public rulings on international tax issues. We also provide targeted information and tools through printed publications, telephone enquiry services and our website.

Where possible, we collaborate with tax authorities in other countries to provide consistent advice and mutual support. For example, in 2006–07 we will continue to cooperate with the New Zealand Inland Revenue Department to improve processes for businesses operating in both jurisdictions.

We collect and analyse data on international transactions to verify compliance and identify aggressive international tax practices. In particular, we use reports from the Australian Transaction Reports and Analysis Centre (AUSTRAC) to:

- profile individual industries, occupations and geographical areas
- identify potentially high-risk transactions
- identify and quantify compliance risks, and
- select cases for further investigation.

We also cooperate with tax authorities in other countries to achieve the common goals of deterring, detecting and dealing with aggressive international tax planning schemes. This includes:

- sharing best practices – for example, techniques for identifying residents who hold debit or credit cards that were issued offshore (an indicator of tax evasion)
- sharing intelligence about trends and drivers in aggressive tax planning and tax evasion, and developing international solutions
- assisting Treasury in its negotiation of treaty arrangements with other countries to improve exchange of information, and
- exchanging taxpayer-specific information and engaging in simultaneous audits with our tax treaty partners.

Where our investigation of cross-border arrangements finds evidence of criminal activity, we refer cases to law enforcement agencies for prosecution (see the 'Serious evasion and fraud' chapter).

HEADLINE ISSUES

Each year we revise our compliance focus to treat new, emerging and existing risks.

New and expanded priorities

In 2006–07 we are placing more emphasis on:

- helping smaller businesses and their advisers comply with international tax obligations, particularly where they have infrequent or complex international transactions
- examining profit shifting among smaller businesses, particularly where it involves intangibles such as patents, trademarks and rights (including related royalties) and services such as management fees
- scrutinising promoters of schemes that operate out of Vanuatu and the Pacific region, particularly where they have associates in Australia
- examining where profit shifting may occur, particularly:
 - sales of intellectual property
 - business restructures
 - guarantee fees
 - multinationals with related-party dealings in tax havens, and
 - multinationals with headquarters in Australia that provide services and intellectual property to offshore affiliates
- analysing data on property ownership to identify foreign residents who have not declared rental property income or capital gains
- investigating high-risk arrangements that involve a tax haven or countries that do not provide income and banking information to Australia
- monitoring the use of entities and financial instruments to exploit the tax rules of two or more jurisdictions to obtain unintended tax benefits, and
- checking whether payers are withholding tax from payments to foreign residents.

Continuing priorities

In 2006–07 we are continuing to focus on:

- providing information and rulings to help businesses and individuals understand and comply with their international tax obligations
- building our relationships with tax authorities in other jurisdictions and developing tax information exchange agreements
- improving risk profiling of taxpayers by refining our data analysis and our data matching systems, and
- monitoring flows of foreign source income and capital gains of Australian residents.

OUR FOCUS

Tax havens and countries with bank secrecy

This year we are continuing to examine arrangements that involve tax havens and countries with bank secrecy to identify attempts to avoid Australian tax obligations.

We are focusing on:

- promoters of such arrangements, including people in Australia who are associates of offshore promoters, or act as intermediaries for them, and
- significant cases in the large business segment where:
 - there has been an internal restructure involving the creation of new entities and the transfer of intellectual property
 - there has been a transfer of functions, assets or risks to tax havens or countries with bank secrecy, and/or
 - dealings with related parties offshore do not result in commercially realistic profit or tax outcomes.

We continue to educate and inform taxpayers about the risks of participating in inappropriate tax haven arrangements, through:

- print and electronic publications – for example, the *Tax havens and tax administration* booklet, tax practice statements and public rulings, and
- public announcements about compliance activities, including prosecutions.

This year we will identify and address cases of non-compliance involving tax havens and countries with bank secrecy by:

- monitoring transactions to identify high-risk activities, using a range of information sources – for example, AUSTRAC reports, returns, offshore debit and credit card transaction records, the internet, and information from other tax authorities
- querying taxpayers about their international dealings
- auditing high-risk cases, and
- prosecuting promoters of and participants in aggressive cross-border schemes (see the 'Serious evasion and fraud' chapter).

We are also expanding our relationships with tax authorities in other countries to address the misuse of tax havens by:

- sharing information and best practice with Canada, France, Germany, Japan, the United Kingdom and the United States through the Seven Country Forum on Tax Havens

- developing international solutions through the Organisation for Economic Cooperation and Development (OECD), the Global Forum on Taxation, and the Joint International Tax Shelter Information Centre, and
- negotiating tax information exchange agreements with key jurisdictions, in cooperation with Treasury.

Profit shifting

This year we are continuing to examine profit shifting – the use of arrangements between related Australian and offshore entities to shift profits (and tax) from Australia to other countries.

We scrutinise large businesses that have substantial international related-party dealings and declare lower than expected profits. We compare the profitability and tax performance of multinational businesses across all industry groups, and profile particular businesses, to identify suitable cases to review. We will audit a number of large businesses and small to medium enterprises.

Our profiling focuses on:

- intangibles, including trade names, business models, intellectual property and marketing intangibles
- business restructures
- guarantee fees, and
- dealings with related parties in tax havens.

In particular, we are monitoring the related-party dealings of Australian businesses with enterprises in emerging economies to ensure they involve appropriate arm's-length arrangements.

This year we are continuing to support advance pricing arrangements and mutual agreement procedures. We maintain a strong involvement in developing global approaches to transfer pricing through peak international forums, particularly the OECD.

Goods and services tax issues

To ensure that the goods and services tax (GST) is properly accounted for, this year we are:

- investigating whether businesses in Australia that reorganise their structures or transactions to remove a connection with Australia have legitimate commercial reasons for doing so
- continuing to cooperate with overseas tax authorities to share intelligence and develop responses to aggressive tax planning that involves cross-border transactions

This year we are continuing to examine arrangements that involve tax havens and countries with bank secrecy to identify attempts to avoid Australian tax obligations.

- educating taxpayers to ensure they understand and comply with their obligations and auditing businesses at high risk of not complying, and
- investigating foreign residents who register for GST to claim input tax credits but do not remit GST on taxable supplies connected with Australia.

We are collaborating with industry representative organisations to ensure that our advice on cross-border transactions is well understood. We will conduct audits to ensure that GST is accounted for on supplies that are contractually made to a foreign resident but actually provided to an entity in Australia.

Cross-border financing

This year we are monitoring international financing arrangements to identify attempts to obtain benefits not intended in Australian tax law, or to take advantage of inconsistencies between Australian and overseas tax laws.

Cross-border financing arrangements typically use hybrid entities and hybrid financial instruments to reduce the cost of funds by taking advantage of inconsistencies between the laws of different jurisdictions. These arrangements seek to:

- duplicate tax benefits, such as deductions or credits across countries, and/or
- receive different revenue or capital classification across countries.

We continue to monitor this constantly evolving area of commercial practice and conduct audits in appropriate cases. Where we consider that the law is not operating as intended, we inform Treasury.

Outbound investors

We continue to compare information from a range of sources to identify residents who have received overseas income but have not declared it.

Under our automatic exchange of information program we receive data from 21 treaty partners, which we match against income disclosed in tax returns. We are negotiating more electronic exchanges each year.

Facilitation payments

We are also checking that businesses have sound systems in place to detect international facilitation payments, so that deductions for expenses and input tax credits are properly claimed (see the 'Large businesses' and 'Small to medium enterprises' chapters).

Foreign residents

To ensure that foreign residents comply with their Australian tax obligations, this year we are:

- examining whether Australian taxpayers are withholding and remitting tax on interest, dividends and royalties on behalf of foreign residents where required
- checking that those who are required to withhold tax from payments to foreign residents comply with their obligation to lodge annual withholding payment reports
- collaborating with industry representative organisations to ensure that the foreign resident withholding obligations are well understood
- identifying foreign residents who have not declared income, or capital gains from real property and other assets connected with Australia, to check they comply with their obligations, and
- examining foreign resident GST registrations to confirm input tax credits are properly claimed and GST is accounted for on taxable supplies connected with Australia.

We also use information from the Department of Immigration and Multicultural Affairs to confirm non-residents' eligibility to access superannuation entitlements when they depart Australia permanently.

COMMISSIONER'S ADVICE

- If you are doing business or investing overseas, you can find information to help you manage your tax affairs at www.ato.gov.au – select 'Tax topics explained' – 'International' – 'For Businesses'. You will find information and publications on a range of topics including transfer pricing and tax havens.
- If you are an Australian resident who earns foreign income or you are not an Australian resident but are working or investing in Australia, you can find information to help you manage your tax affairs at www.ato.gov.au/individuals – select 'Tax topics explained' – 'International tax essentials'.

PRELIMINARY RESULTS FOR 2005–06

Highlights of key activities

Rulings

3 public rulings, 7 determinations, 4 draft rulings and 8 draft determinations published, addressing:

- foreign income and losses
- functional currency provisions
- shipping
- withholding, and
- treaties.

Tax havens

- Negotiations undertaken on 9 information exchange agreements that will allow us to exchange tax-related information upon request with these countries.
- A tax information exchange agreement signed with Bermuda in November 2005.
- 240 reviews conducted generating 7 voluntary disclosures, and raising \$1.8 million in additional tax and penalties.
- 75 audits conducted, raising \$33.6 million in additional tax and penalties.
- 345 additional returns lodged, returning \$8.6 million in taxable income.
- See additional results in the 'Serious evasion and fraud' chapter under 'Project Wickenby'.

Profit shifting

Large businesses

- 24 risk reviews completed, 27 audits conducted, 10 finalised (with a focus on transfer pricing), raising \$44 million in tax and penalties and \$540 million in loss adjustments.
- 19 advance pricing arrangements¹ finalised, comprising 12 bilateral and 7 unilateral arrangements.
- 7 mutual agreement procedures² finalised, with another 10 under way.

Small to medium enterprises

- 80 reviews of Schedule 25A lodgments completed.
- 40 risk assessments completed.
- 12 audits finalised, resulting in \$13.6 million in tax and penalties and \$77.8 million in loss adjustments. Another 13 are in progress, with a focus on transfer pricing.
- 8 advance pricing arrangements entered into, comprising 2 bilateral and 6 unilateral arrangements.
- 6 mutual agreement procedures finalised, with 1 under way.

Relationships with foreign tax administrations

- Hosted visits from 22 foreign tax administrations (117 delegates) to enhance our cross border cooperation. Countries who have visited include China, Fiji, Indonesia, Ireland, Japan, New Zealand, Singapore, Thailand, United Kingdom and Vietnam.
- Provided technical assistance for major whole-of-government projects in Papua New Guinea and Indonesia. Contributed to 15 Organisation for Economic Cooperation and Development (OECD) outreach technical assistance workshops in China, India, Malaysia and South Korea.
- Participated in leading international tax forums, including the OECD, Pacific Association of Tax Administrators, Study Group of Asian Tax Administration and Research, the Commonwealth Association of Tax Administrators, and the Seven Country Forum on Tax Havens.
- Processed over 650 separate cases under our tax treaty exchange of information program. In addition, provided over 1.5 million income records under our automatic exchange of information program (regarding dividends, interest and unit trust distributions) to 42 treaty partners. Similar information has been received from 21 treaty partners, aiding our efforts to prevent international tax avoidance and evasion.

1 An arrangement that determines in advance of controlled transactions an appropriate set of criteria for the determination of the transfer pricing for those transactions over a fixed period of time. It may be unilateral involving the taxpayer and us, bilateral or multilateral involving the agreement of two or more tax administrations and their respective taxpayers.

2 A means through which tax administrations consult to resolve disputes regarding the application of double tax conventions. It can be used to eliminate double taxation that could arise from a transfer pricing adjustment.

Aggressive tax planning

PROFILE

The use of transactions or arrangements that have little or no economic substance and are created predominantly to obtain a tax benefit that is not intended by the law constitutes aggressive tax planning.

Although most of Australia's taxpayers do not get involved in aggressive tax planning schemes, a small minority do promote, market or participate in schemes designed to undermine the tax system.

Aggressive tax planning arrangements are becoming increasingly complex and sophisticated, and can be difficult to detect.

Promoters of aggressive tax planning arrangements may now be subject to sanctions under the new promoter penalty laws that came into effect on 6 April 2006.

OUR GENERAL APPROACH

Our straightforward approach to countering aggressive tax planning involves:

- early detection of emerging schemes
- warnings to taxpayers
- fair treatment of participants, and
- firm action against promoters.

We conduct targeted media campaigns and advertising, and provide information and advice on our website, for people thinking about investing in tax-effective projects.

We encourage investors to obtain independent financial and tax advice.

We encourage promoters of managed investment schemes to apply to us for product rulings that provide certainty to taxpayers on the deductions that can be claimed for their schemes. We conduct checks to ensure that managed investment schemes are implemented as described in their product rulings, and to identify schemes that have proceeded without product rulings.

We list the current product rulings on our website. If we have not issued a product ruling for a specific managed investment scheme, we encourage potential investors to apply to us for a private ruling about the tax implications of investing in the scheme.

When we identify a potentially aggressive tax arrangement, we analyse it. We use information from a wide range of internal and external sources, including information that is:

- publicly available
- drawn from compliance activities such as reviews and audits
- drawn from tax returns, activity statements and applications for private, product or class rulings
- volunteered to us by the community and the tax profession
- provided by other government organisations, such as the Australian Transaction Reports and Analysis Centre (AUSTRAC), and/or
- obtained through formal exchanges with tax authorities in other countries.

If necessary, we publish an early warning, called a taxpayer alert, on our website. As soon as possible, we provide details of our view on the application of the tax law to the facts of the arrangement to enable taxpayers to make informed decisions about the risks posed by participating in the arrangement.

We also write to people who have participated in the tax scheme, and provide options to help them meet their tax obligations. The options may include:

- not claiming the inappropriate tax benefit
- voluntarily disclosing their participation and amending their return, or
- accepting terms of settlement with us on the tax, interest and penalties to be paid.

Our response to taxpayers' involvement in schemes, particularly in relation to payment options, is guided by their individual circumstances, including their compliance history and/or previous participation in aggressive tax planning arrangements.

When we identify a promoter of an aggressive tax planning scheme, we generally contact them to alert them to our concerns and the possible use of the new promoter penalty laws.

Where arrangements are particularly aggressive and we believe there is the potential for criminal activity, we cooperate with other government organisations, such as the Australian Federal Police (see the 'Serious evasion and fraud' chapter).

HEADLINE ISSUES

Each year we revise our compliance focus to treat new, emerging and existing risks.

New and expanded priorities

In 2006–07 we are placing more emphasis on:

- implementing the new promoter penalty laws
- improving our capability to detect schemes that use superannuation as an aggressive tax planning mechanism
- monitoring and countering arrangements that involve:
 - the use of outbound and inbound offshore re-invoicing arrangements to avoid Australian tax, and
 - asset transfers to offshore structures to avoid Australian tax, and
- countering attempts by promoters to construct arrangements that make it difficult for us to collect tax owing.

Continuing priorities

In 2006–07 we are continuing to focus on:

- analysing the risks posed by promoters and advisers who create arrangements tailored to a particular taxpayer and then market them to other taxpayers
- monitoring and dealing with promoters and advisers who devise aggressive tax planning arrangements
- providing product rulings that give taxpayers certainty if the arrangements are implemented as described in the product ruling
- ensuring the integrity of the product ruling system by checking that arrangements are implemented as described in the product ruling
- monitoring and countering certain types of:
 - prepayment and financing arrangements, including prepaid service warrants
 - arrangements involving corporate limited partnerships, and
 - employee benefit arrangements
- cooperating with tax authorities in other countries to combat aggressive tax planning – for example, through the Joint International Tax Shelter Information Centre
- monitoring and dealing with promoters of international tax arrangements that appear to be aimed at avoiding tax in multiple jurisdictions including Australia – particularly those that involve offshore transactions in tax havens. Project Wickenby is a response to one form of this type of aggressive tax planning (see the 'Serious evasion and fraud' chapter)
- monitoring arrangements designed to reduce exposure to capital gains tax not intended by the law
- monitoring and countering arrangements designed to create goods and services tax (GST) benefits not intended by the law, and
- finalising the outstanding cases relating to schemes marketed before 30 June 2003 where taxpayers have chosen to have their final tax liability determined by the courts, and ensuring that participants who have accepted our settlement offers meet their debt repayment commitments.

OUR FOCUS

Early detection and response

This year we are improving our capabilities to detect aggressive arrangements and alert taxpayers to the risks of these arrangements earlier and more effectively. For example, we are using sophisticated web trawling and data mining software to gather intelligence on schemes.

Product rulings

We continue to provide certainty to investors by issuing product rulings. We check whether arrangements are implemented as described in their product ruling.

If a managed investment scheme applied for but did not receive a product ruling, or simply went ahead without a ruling, we may review the tax deductions available to investors in that scheme. Where necessary, we write to people who have participated in the scheme to alert them to their tax obligations.

If a managed investment scheme was not implemented as described in its product ruling we consider the nature of the variation:

- for minor variations, we may issue an addendum to the ruling to provide guidance to taxpayers on what the variation may mean for their tax obligations
- for material variations, the ruling affords no protection to the investors.

Dealing with promoters

This year we will implement new promoter penalty laws that apply in two circumstances:

- when a promoter engages in conduct that results in them or another entity being a promoter of a tax exploitation scheme, or
- when an individual or entity implements a scheme promoted on the basis of conformity with a product ruling in a way that is materially different to that described in the product ruling.

The new laws allow us to apply to the Federal Court for:

- an injunction, and/or
- a civil penalty order.

The maximum penalty that can be imposed is the greater of:

- 5,000 penalty units (currently equal to \$550,000) for an individual or 25,000 penalty units (\$2.75 million) for a body corporate, or
- twice the proceeds of the scheme.

The new laws also allow us to enter into voluntary undertakings with scheme promoters. The new penalty regime will mean that promoters can no longer pass on all the tax risks to investors.

The introduction of the penalty regime for promoters is designed to:

- allow the market for investment schemes to operate more efficiently, by increasing the potential for investment capital to be redirected to legitimate and productive investments, and
- enhance confidence in the integrity of Australia's tax system, with potential flow-on benefits for tax compliance.

We are co-designing our administrative approach in collaboration with tax professionals and the wider community. We are doing this to ensure that we administer the new provisions fairly and reasonably and that the laws do not have unintended impacts.

Goods and services tax schemes

We continue to look for tax arrangements that use mechanisms such as internal transactions, non arm's-length dealings or interposed entities to gain GST benefits not intended by the law.

This year we are particularly focusing on:

- property arrangements that attempt to avoid or reduce GST payable
- second-hand goods schemes, particularly those that interpose an entity to create an improper input tax credit claim
- timing schemes, particularly those that accelerate and/or inflate input tax credit claims for a purchaser operating on a non-cash basis of accounting, while delaying GST liability for a vendor operating on a cash basis

This year we are improving our capabilities to detect aggressive arrangements and alert taxpayers to the risks of these arrangements earlier and more effectively.

- phoenix arrangements – arrangements to evade tax through the deliberate, systematic and cyclic liquidation of related corporate trading entities – that involve the creation of input tax credits through the acquisition of assets of a debt-ridden entity by a related party
- contrived international arrangements, such as business restructuring schemes designed to sever a connection with Australia and avoid GST obligations, and
- financial supply arrangements where interposed entities and/or special-purpose vehicles are used to inflate input tax credit claims.

We will continue to monitor indirect tax advisers who market and/or encourage growth in aggressive arrangements.

Arrangements to reduce personal income tax

People with high incomes are often targeted by promoters of schemes that misuse non-profit, tax-exempt or loss making entities to reduce liability for income tax.

This year we are continuing to closely examine the use of:

- arrangements between charities and controlling entities, including those where associated individuals or entities may be deriving a benefit from the charity, and
- arrangements using interposed entities, such as trusts, to alienate gains from the exercise of executive or employee share options.

Financial products

We are monitoring the use of high-risk financial products such as:

- corporate financing arrangements that seek to split the debt interest from wider arrangements for debt equity purposes, and
- arrangements that enable an investor to gain the benefit of tax credits without being exposed to economic risk.

Achieving fair settlement

Where a dispute arises between a group of taxpayers and the Tax Office, a panel of senior tax officers reviews proposals for an agreed settlement. We seek to achieve consistent and fair treatment of groups of taxpayers who want to settle their disputes with us. Wherever possible, we personally inform each of the affected taxpayers of our indicative settlement positions.

Settlements may include a range of options to help taxpayers pay the tax they owe. If they face financial or other difficulties, we allow them a reasonable time to pay their debts by instalments. Where the payment of the tax will cause serious financial hardship, we encourage them to apply for a release from all or part of the tax debt. If a taxpayer fails to come to an arrangement with us or to comply with an agreed arrangement, we take fair but firm action to recover the outstanding amount. This may include issuing garnishee notices or commencing bankruptcy proceedings.

We encourage taxpayers who wish to discuss settlement to contact us.

COMMISSIONER'S ADVICE

- Before you invest in any managed investment scheme, you can check whether:
 - it has a valid product ruling, go to www.ato.gov.au/atp
 - the promoter is licensed and if a current product disclosure statement or prospectus has been lodged with the Australian Securities and Investments Commission, go to www.fido.asic.gov.au
- If it sounds too good to be true, you should get independent professional advice or seek a private ruling from us – a simple form is available at www.ato.gov.au/atp
- If you have any concerns about the tax implications of any arrangement you are involved in, you can telephone us on **1800 177 006**, 8.00am to 6.00pm, Monday to Friday.

PRELIMINARY RESULTS FOR 2005–06

Highlights of key activities

Finalising schemes marketed before June 2003

- Over 80% of employee benefit arrangement cases and 95% of mass marketed investment schemes cases have finalised their disputes.

Providing certainty to taxpayers

- Around 130 product rulings across a number of industries issued:
 - afforestation 50
 - agribusiness 60
 - films 9
 - financial products 10
- 25 integrity checks of higher-risk product rulings undertaken.
- 2 GST public rulings that set out our view in relation to a series of taxpayer alerts were issued.

Stopping aggressive arrangements

We have prevented the spread of a number of aggressive arrangements by:

- publishing 7 taxpayer alerts, which are available on our website and address our concerns with:
 - copyright arrangements in consolidated groups
 - prepaid service warrants
 - offshore avoidance structures, and
 - barter exchange schemes
- sending 680 early warning letters, and
- conducting 40 access and information visits.

In addition we:

- asked for 160 early and expanded returns from higher risk promoters. 6 promoters prosecuted for non-lodgment, and
- demanded lodgment of outstanding returns from promoters and associates which resulted in the lodgment of 360 returns and around \$2 million in tax payable.

Serious evasion and fraud

PROFILE

A small number of people deliberately engage in criminal behaviour to evade their tax obligations or fraudulently use the system to obtain an improper financial benefit.

They may do this by:

- stealing the identities of other people
- creating false identities
- forging documentation
- not declaring income (from legal or illegal activities)
- not registering in the system
- creating dishonest arrangements to evade tax liabilities, and/or
- creating false transactions.

Serious evasion and fraud threaten the revenue system:

- directly, by reducing the revenue collected, and
- indirectly, by undermining community confidence in the system.

Serious evasion and fraud are committed by both opportunistic individuals and organised groups, and are often associated with other forms of crime. Techniques for committing serious evasion and fraud are constantly evolving and becoming more sophisticated, as are law enforcement agencies' methods of detecting and dealing with such behaviour.

In recent years identity crime is increasingly being used to commit tax fraud. This is helped by the increased use of online facilities, which has provided opportunities for illegally tapping into business and personal

data flows – including email and internet transactions – to disguise money flows and create false electronic business transactions in other countries.

OUR GENERAL APPROACH

We combat serious evasion and fraud by:

- using sophisticated intelligence gathering techniques, and collaborating with other organisations in Australia and overseas to monitor and analyse non-compliance
- applying tax penalties
- undertaking investigations, including jointly with law enforcement agencies, where we suspect serious evasion and fraud with a view to prosecution action, and
- publicising cases and penalties where criminals are convicted and sentenced for serious tax evasion and/or fraud.

In recent years we have:

- strengthened our capabilities for deterring, detecting and dealing with serious tax evasion and fraud involving offshore arrangements, and
- significantly improved our intelligence gathering and early detection and response capabilities by developing a much better understanding of the methods and processes used in attempts to defraud the revenue system.

Because serious evasion and fraud are often associated with other crimes, we often cooperate with other agencies to investigate serious breaches. Where necessary, we participate in multi-agency task forces involving national, state and territory government organisations, such as Project Wickenby.

We also cooperate with tax authorities in other countries, sharing information under tax treaties or government-to-government agreements.

We take firm action against taxpayers, intermediaries and others who engage in serious evasion and fraud.

We refer serious breaches to the Commonwealth Director of Public Prosecutions (CDPP) to consider for criminal prosecution. In simpler cases, such as where people refuse to lodge returns despite repeated warnings, we prosecute under a delegated authority from the CDPP.

We complement our criminal investigation work with civil audit work to ensure that tax is accounted for on all income, even income from crime.

HEADLINE ISSUES

Each year we revise our compliance focus to treat new, emerging and existing risks.

New and expanded priorities

In 2006–07 we are placing more emphasis on:

- prosecuting serious cases where people, despite repeated requests and warnings, refuse to comply with their tax obligations, and
- conducting fewer reactive individual investigations and audits, and instead working more through multi-agency task forces, such as Project Wickenby.

Continuing priorities

In 2006–07 we are continuing to focus on:

- countering organised attempts to defraud the tax system, in particular by:
 - targeting the promoters of more extreme aggressive tax schemes, including schemes that launder money, defraud others or abuse superannuation funds by illegally accessing funds, and
 - curbing illicit tobacco trafficking and fraudulent fuel claims
- detecting and preventing the use of false or stolen identities to defraud the tax system, and
- detecting and preventing fraudulent behaviour by tax practitioners.

PROJECT WICKENBY

The Project Wickenby task force will be at the forefront of our efforts to combat serious evasion and fraud this year, and demonstrates how we cooperate effectively with other government organisations to address abuses of the tax system.

Project Wickenby was formed to investigate a suspected case of widespread, systematic tax evasion. A number of government organisations, including the Tax Office, the Australian Crime Commission, the Australian Federal Police and the Australian Securities and Investments Commission, play a role in the task force.

Based on information gathered by Project Wickenby, in June 2005, warrants to seize documents were executed at 48 sites across Australia. The Tax Office also used its own access powers to make unannounced visits to another 37 sites.

Our preliminary analysis indicates a large number of suspected offences, spanning tax law, corporations law and criminal law.

We now have a good understanding of the scale and nature of the non-compliance, which apparently centres on the creation of fictitious transactions, facilitated by offshore promoters.

The Government has allocated the Tax Office \$160 million, out of \$305 million in joint agency funding, over six years to investigate and prosecute offences identified by the Project Wickenby task force.

Almost all recent tax-related prosecutions have been successful, and approximately 60% of convictions have resulted in prison sentences.

OUR FOCUS

We focus on the more extreme aspects of tax evasion and fraud, particularly those that may constitute criminal behaviour, such as refund fraud. We are committed to deterring, detecting and dealing with such behaviour.

Deterrence

This year we are deterring serious evasion and fraud by:

- strengthening our systems, such as registration processes, and
- publicising cases and highlighting the penalties applied.

In particular, we use media releases to draw attention to jail sentences arising from criminal prosecutions for serious evasion and fraud.

Detection

This year we are using a range of information to detect serious evasion and fraud, including information:

- volunteered by community members through our confidential telephone service (**1800 060 062**)
- submitted in returns and registrations
- gathered by the Australian Transaction Reports and Analysis Centre (AUSTRAC) and other government organisations, and
- from our general compliance activities, such as business registration checks and record keeping reviews.

We use a range of tools and techniques to analyse the information to:

- monitor trends and identify activities outside 'normal' compliance practice, and
- investigate cases of apparently deliberate non-compliance.

To support our investigations we will use our access powers, where necessary, to make unannounced visits to obtain information and material, or require information to be produced. For potentially criminal matters, we usually involve law enforcement agencies such as the Australian Federal Police to obtain evidence.

This year we will undertake more multi-agency operations to share information and resources and facilitate the use of a wider range of powers and responses. Where there is evidence of inter-jurisdictional criminal activity, we will also collaborate with tax authorities and law enforcement agencies in other countries.

Remedies

Depending on the seriousness of a case of evasion or fraud, we:

- prosecute for failing to respond to our notices to give information or lodge returns
- amend the taxpayer's assessment and demand payment of the outstanding amount
- apply a penalty of up to 200% of the tax shortfall
- work with law enforcement agencies to apply the *Proceeds of Crime Act 2002* civil forfeiture provisions to recover gains from criminal behaviour, and
- refer the case to the CDPP for criminal prosecution.

Our settlement agreements do not include undertakings not to prosecute.

Where we believe we have established evidence of a criminal offence, we refer the case to the CDPP. In accordance with our guidelines with the CDPP, we do not refer for prosecution unless we believe there is sufficient admissible evidence likely to prove an offence, and a reasonable prospect of conviction based on that evidence.

Ultimately, prosecution is the prerogative of the CDPP. However, under an authority from the CDPP, we directly prosecute a range of summary tax offences. For example, we can prosecute failure to lodge an income tax return or an activity statement under the *Taxation Administration Act 1953*.

Penalties for criminal offences include jail terms – for example, up to 10 years for fraud or 20 years for money laundering. Almost all recent tax-related prosecutions have been successful, and approximately 60% of convictions have resulted in prison sentences.

Working with law enforcement agencies, such as the Australian Federal Police and the Australian Crime Commission, we seek to apply provisions of the proceeds of crime legislation in appropriate cases. In 2005–06 we were involved in cases where confiscation orders to the value of \$27 million were obtained.

Our cooperation with the Australian Crime Commission led to the 2006 conviction of three principals of a prominent Sydney fashion outlet that had failed to declare \$15 million in sales. Each of the three defendants was sentenced to serve more than eight years in jail.

Another recent example involves three accountants who were each sentenced to serve five years in jail for conspiring and devising a tax fraud that resulted in a loss of nearly \$27 million.

In the course of the accountants' appeals, Justice Steytler, in the Court of Appeal Division of the Supreme Court of Western Australia, cited the following comments of Justice Vincent in *Director of Public Prosecutions (Commonwealth) v Goldberg* (2001) 184 ALR 387 at 394 [32]:

Tax evasion is not a game, or a victimless crime. It is a form of corruption and is, therefore, insidious. In the face of brazen tax evasion, honest citizens begin to doubt their own values and are tempted to do what they see others do with apparent impunity.

COMMISSIONER'S ADVICE

- You can report tax evasion and fraud information to our confidential phone service on **1800 060 062**, 8.00am to 6.00pm, Monday to Friday.
- If you use a tax agent, you should ensure they are registered. You can ask to see their Certificate of Registration from the Tax Agents' Board or check the website www.tabd/list/default.asp
- Protecting your tax file number and other identity documents will help protect you against identity crime. Also make sure that your computer has appropriate anti-virus protection.

PRELIMINARY RESULTS FOR 2005–06

Highlights of key activities

Audit results

- \$121.4 million liabilities raised, including \$67.2 million assessments, \$33.1 million penalties and \$21.1 million interest.
- \$58.8 million collected.

Investigation results

- 170 briefs of evidence referred to the CDPP.
- 3 briefs of evidence referred to the Australian Government Solicitor.
- 60 penalty infringement notices issued.
- 18 tobacco cutting machines, 9 motor vehicles, 60 tobacco plants/seedlings, 6 tonnes of cut tobacco and 12 tonnes of tobacco leaf seized.

Proceeds of crime results

Proceeds of crime action can arise from both our audit and investigation activity.

- \$15 million restrained.
- \$27 million confiscated.
- \$9.8 million recovered.

Note: The Tax Office is not an authorised agency for the purposes of proceeds of crime legislation – outcomes are achieved in collaboration with authorised agencies (predominantly the Australian Federal Police) for tax-related matters.

Prosecution results

- 100 cases dealt with by the courts.
- 100 convictions.
- 55 prison sentences, ranging from 3 months to 8 years.
- \$1.2 million in fines payable to the courts.
- \$3.6 million in reparation orders payable to the Tax Office.

Project Wickenby results

- 18 voluntary disclosures received.
- 2 tax settlement offers received with \$3.2 million accepted in one matter.
- A spouse of a taxpayer currently under criminal investigation lodged a return declaring capital gains derived from shares involved in Project Wickenby activities with a tax liability of \$716,000.
- Exercised our powers of access to conduct a second round of unannounced visits at 27 sites across Australia on 21 June 2006.
- The Australian Crime Commission has, in July 2006, charged three participants with conspiracy to defraud the Commonwealth.

03

INTERMEDIARIES

TAX PRACTITIONERS
EMPLOYERS AND OTHER INTERMEDIARIES

Intermediaries play key roles in the revenue system, supporting taxpayers to comply and helping us to monitor, review and improve compliance.

This section outlines how we work with intermediaries to maximise their compliance and that of their clients, and to reduce compliance costs.

Tax practitioners

PROFILE

Tax practitioners are tax professionals such as tax agents, tax advisers and legal practitioners who are legally authorised to provide advice to taxpayers, to otherwise deal with us on behalf of taxpayers, or to prepare and lodge documents for taxpayers. For the purposes of this booklet, tax practitioners also include bookkeepers who provide services to businesses.

Tax practitioners play an important role in maintaining the integrity and efficiency of the tax system, providing a key compliance leverage point to influence taxpayer behaviour. A capable and well regulated tax profession benefits the tax system.

There are almost 26,000 registered tax agents in Australia. Collectively, they lodge around 74% of income tax returns for individuals and over 95% of returns for businesses. Many agents also provide financial advice and/or act as independent auditors of self managed superannuation funds.

There are more than 120,000 people working in the bookkeeping industry in Australia. We estimate that around 10% to 15% of bookkeepers prepare and lodge business activity statements on behalf of clients.

Some legal practitioners:

- represent their clients before tribunals, courts and the Commissioner on tax matters
- prepare documents regarding tax matters, and/or
- advise on the interpretation of tax and related law.

Although most tax practitioners fully comply with tax obligations, non-compliance occurs where:

- tax practitioners fail to meet their personal lodgment or payment obligations
- tax practitioners do not keep up to date with developments in taxation
- tax practitioners promote or participate in aggressive tax planning arrangements
- tax practitioners engage in deliberate evasion or fraudulent activities, or
- unauthorised people represent themselves as tax practitioners and illegally charge fees to provide tax-related services, such as preparing tax returns for other taxpayers.

OUR GENERAL APPROACH

From our perspective, supporting and influencing one tax practitioner means we can support and influence many taxpayers. We support tax practitioners to help them perform their roles by providing:

- a range of communication and support options
- advice and education services, and
- electronic tools to transact with us.

We consult with tax agents directly and through their professional bodies on administrative processes, and try to ensure that products and services are co-designed with participants in the industry.

We expect tax practitioners to:

- encourage taxpayers to fully disclose tax-related information to them
- be competent
- act ethically and professionally in providing quality advice and services to their clients, and
- ensure, to the best of their ability, that information supplied to us is complete and accurate.

We expect tax practitioner professional associations to:

- promote the values of the tax profession and the standards of behaviour expected of members, and
- respond appropriately where complaints are made about a member.

We collaborate with tax practitioners, their professional bodies and the Tax Agents' Boards to ensure high standards of tax practitioner integrity in the interest of protecting taxpayers.

We also cooperate with tax practitioners and their representatives to achieve common goals such as:

- designing new working arrangements that better meet the needs of tax practitioners, particularly tax agents
- improving tax agent capabilities and the effective regulation of the profession
- securing stronger industry support for the scrutiny of tax agents who operate outside acceptable industry norms, and
- improving the quality of bookkeeping services and the integration of bookkeepers with the wider tax profession.

We use a wide range of information to profile tax agents and identify those with clients who are operating outside 'normal' compliance practice and who are at high risk of not complying.

When we identify a tax agent who meets our risk criteria, we contact them to see whether their tax practices are contributing to their clients' risk levels. Where necessary, we help agents address poor business practices.

Where agents do not comply, and fail to deal with compliance problems that we have brought to their attention, we may need to take firmer action. This can range from audit through to

referral for prosecution and/or to the relevant Tax Agents' Board for review. We may also withdraw certain kinds of support and apply administrative sanctions – for example, denying access to lodgment deferrals and the lodgment program.

A small minority of tax practitioners abuse their position of trust and engage in deliberate evasion or fraudulent activities (see the 'Serious evasion and fraud' chapter). We refer such agents to the relevant Tax Agents' Board to review their registration and, where criminal activities are involved, we refer them to law enforcement agencies.

HEADLINE ISSUES

Each year we revise our compliance focus to treat new, emerging and existing risks.

New and expanded priorities

In 2006–07 we are placing more emphasis on:

- collaborating with tax practitioners and their representatives to design and deliver improved working arrangements, products and services
- co-designing major initiatives for the 2007–08 and future lodgment programs with tax practitioners
- building our relationship with bookkeepers, and providing products and services that increase their capability

- improving our processes to identify and respond to tax agents who operate outside acceptable industry norms
- working with professional bodies to strengthen tax agent capabilities and skills – for example, through shared training programs
- responding to complaints made by tax agents about the activities of others, and
- co-designing with the tax profession practical arrangements to support the Government's announced intention of modernising the tax agent regulatory system.

Continuing priorities

In 2006–07 we are continuing to focus on:

- analysing tax agent practices to identify compliance behaviour
- using profiling and community information to identify compliance risks and deter fraud and evasion before it occurs
- monitoring and, where necessary, reviewing tax agents' compliance with their own tax obligations and the lodgment program
- monitoring the tax compliance of members of the legal profession
- referring for prosecution those who charge fees for tax-related services but are not authorised to do so, and
- taking firm action where tax practitioners choose to engage in or support activities relating to tax evasion or fraudulent and criminal activity.

REGISTERING IN THE SYSTEM

In May 2006 the Australian Government announced its intention to implement a new national legislative framework for tax practitioners. We will collaborate with other government organisations and tax practitioner representative bodies this year to co-design the administrative approaches to support the new framework.

Information on the current regulatory framework can be obtained from the state Tax Agents' Boards. In particular, the boards can advise and help people who want to register as a tax agent, or make a complaint about an agent.

The Tax Agents' Boards are independent statutory bodies established in each state. The *Income Tax Assessment Act 1936* and *Income Tax Regulations 1936* set out the criteria a person must meet to gain and maintain tax agent registration by the boards.

Where we believe that a tax agent has breached the requirements for registration, we refer the matter to the relevant Tax Agents' Board. This may result in the agent being deregistered.

This year we expect to investigate more than 100 people who may be operating illegally as tax agents. We are strengthening the processes whereby tax agents and others can report people who illegally provide tax services. We will follow up complaints about people who are acting as tax agents but are not registered, and refer them for prosecution where appropriate.

Bookkeepers who charge a fee for providing activity statement services currently do not require registration, but they should meet certain requirements under the *Income Tax Assessment Act*. This year we will engage with bookkeepers to ensure they understand these requirements and help them with products and services to improve their tax competency.

MEETING LODGMENT OBLIGATIONS

The tax agent lodgment program allows returns, forms and statements to be lodged progressively according to an agreed timetable. We develop each year's program in collaboration with tax agents and their representatives, taking into consideration agent workloads, revenue obligations, and government and community expectations.

This year we are also working with agents to co-design major lodgment initiatives to improve compliance in 2007–08 and future years.

As part of this work we are:

- improving the lodgment program to help tax agents manage workloads, adopting a 'whole of practice' perspective
- ensuring that tax agents who use the lodgment program meet their obligations on behalf of clients, and
- continuing to monitor how tax practitioners comply with their personal and business lodgment obligations.

We are also:

- tailoring programs to help tax agents bring the lodgments of their poorly complying clients up to date, and
- following up cases of non-compliance by clients of tax agents.

Agent-based reviews this year will focus on high-risk lodgment issues, including:

- where a large number of prior year returns are still outstanding as at 30 June 2006
- partial lodgment compliance issues, particularly where activity statements are lodged but not income tax returns, and
- the level of compliance with the 31 March due date for income tax returns, particularly those of individual and trust clients with large amounts of tax to be paid.

We will also remind tax agents of the need to keep their client lists up to date. The lodgment program for an agent will come under scrutiny if they fail to do so.

We will follow up complaints about people who are acting as tax agents but are not registered, and refer them for prosecution where appropriate.

We are continuing to support agents who are unable to achieve their lodgment program commitments because of extenuating circumstances. We will provide each qualifying agent with dedicated assistance to review commitments and develop an acceptable program to bring their clients' obligations up to date.

Although most tax practitioners fully comply with their personal and business lodgment obligations, our analysis of lodgment patterns identified that 11% of tax agents had outstanding 2004 tax returns at 30 June 2005. We have now reduced that to less than 2% of agents who have not lodged their 2004 returns. We continue to monitor personal lodgment compliance trends across tax agents and other tax professionals.

REPORTING CORRECT OBLIGATIONS

This year we are monitoring and reviewing the accuracy, appropriateness and completeness of taxpayers' compliance with their reporting obligations.

If the clients of a particular tax agent have a history of making inaccurate claims or common mistakes, or are operating outside acceptable industry norms, we contact the agent and ask them to:

- provide information that explains these trends
- verify reported information and substantiate claims, and
- discuss work practices, particularly those used to prepare tax returns.

Where tax agents deliberately or persistently fail to comply, we refer them to the Tax Agents' Board to review their registration. Where there is evidence of criminal behaviour, we also refer the agent to law enforcement agencies for prosecution.

MEETING PAYMENT OBLIGATIONS

At 30 June 2006 around 11% of tax agents had an outstanding debt of more than \$100 with the Tax Office and had no arrangement in place to pay the amount.

This year we are focusing on reducing the number of agents who do not comply with their personal and business tax payment obligations.

If an agent fails to pay by the due date, we write to or telephone them about the outstanding amount.

If an agent fails to come to a payment arrangement with us, or to comply with an agreed arrangement, we will take fair but firm action to recover the outstanding amount. This may include applying a penalty, issuing a garnishee notice, or commencing bankruptcy proceedings or prosecution.

HOW WE SUPPORT TAX PRACTITIONERS

We continue to consult and collaborate with tax practitioners and their professional associations – for example, on streamlining tax administration and ensuring the sustainability of the tax profession.

We identify priority issues and exchange knowledge through the National Tax Liaison Group, regular meetings between leaders of professional organisations and the Commissioner, the ATO Tax Practitioner Forum, the Lodgment Working Party and related issue-focused sub-committees.

This year we are also working with tax practitioner professional associations to co-design and deliver information and education products and services tailored for tax practitioners. This includes collaborating with tax agent associations to host seminars, and participating in their events and discussion groups. We are also supporting educational tax programs that the legal profession provides for its members.

We are working with software developers and tax agents to ensure that legislative and administrative requirements for the new tax year are effectively incorporated into software products (see the 'Employers and other intermediaries' chapter).

We continue to promote the use of digital certificates as the most secure way of accessing the electronic Tax Agent Portal. We are committed to delivering improvements throughout the year that will help tax agents streamline their use of digital certificates.

To assist and improve compliance by tax practitioners, we continue to update and expand the 'Tax professionals' section of our website. The website provides access to:

- the Tax Agent Portal, which gives access to data, forms and email
- technical information and professional publications, including *the TAXAGENT* newsletters
- seminar guides and minutes from our consultative forums
- checklists, including a capital gains tax checklist
- calculators, including a decline in value calculator and a tax offset calculator, and
- a compliance toolkit that sets out our compliance activities, priorities and timeframes.

We also provide an electronic lodgment service, used by most tax agents to electronically lodge income tax returns and activity statements.

This year we are also improving the efficiency of our telephone communication with tax practitioners. In particular, we are consulting with them and their representatives to improve our understanding of why tax practitioners telephone us, and develop more effective ways to deliver information and advice.

We continue to improve our dedicated telephone service for tax agents, which includes:

- dedicated agent contact numbers
- fast response times – we aim to answer 90% of enquiries within two minutes, and
- a client relationship management system that streamlines proof of identity procedures and allows our staff to access details of previous enquiries made by both tax agents and their clients.

We are expanding the system to give our staff immediate access to all correspondence between a tax agent and the Tax Office.

We provide support directly to individual tax agents through our relationship manager program. The program allows agents to request a range of support services, including:

- advice on specific practice management issues
- guidance on our latest information products and tools, and
- face-to-face visits to identify and help with practice issues.

This year we are focusing on providing a more specialised face-to-face service that addresses identified needs. We will use a number of indicators to identify the areas where a particular tax agent is performing outside the 'normal' practice of their peers, and plan a visit to provide them with information and assistance in those areas.

The indicators we will analyse across practices of similar size and client base include:

- lodgment performance, including amendments lodged
- use of the Tax Agent Portal
- use of the electronic lodgment service, and
- use of the dedicated telephone service.

COMMISSIONER'S ADVICE

- If you're a tax agent having difficulties in managing your lodgment program, our Tax Agent Lodgment Assistance service can provide help. You can discuss your circumstances with your relationship manager or send a written request by fax to **1300 550 356**.
- Tax agents can make greater use of our Tax Agent Portal features by reviewing the overviews and demonstrations on our website – go to **www.ato.gov.au** and search for 'portal training'.
- Information for all tax practitioners is at **www.ato.gov.au/taxprofessionals**
This includes:
 - the *Compliance toolkit* to develop a better understanding of our compliance approach and to assess the possible impacts of our compliance activities on your practice and clients, and
 - the *2006 ELS* guide for help using the electronic lodgment service to successfully lodge returns, activity statements, forms and schedules.
- Bookkeepers can find specific information at **www.ato.gov.au/business**. Select 'Operating a business' – 'Bookkeeping essentials'.
- Take a look at the minutes from our consultative forums in relation to industry-wide issues at **www.ato.gov.au/taxprofessionals**

This year we are focusing on providing a more specialised face-to-face service that addresses identified needs.

PRELIMINARY RESULTS FOR 2005–06

Highlights of key activities

- Our premium telephone service for registered tax agents answered over 85% of more than 1.8 million calls within two minutes. The March 2006 *Biannual tracking of tax agents' perception of service and usage of channels survey* indicated that more than 90% of surveyed tax agents were satisfied with their recent telephone contact with us.
- We delivered 270 presentations to over 7,100 tax agents, along with two seminars, one via a DVD supplied to agents in December 2005 and the other at around 200 venues on 20 June 2006, which attracted 16,700 registrations.
- We consulted with tax practitioners on 70 projects across the Tax Office, involving nearly 500 practitioners through user testing, focus groups, surveys, pilots and other activities.
- We conducted 5,000 visits to tax agents through the relationship manager program. In addition, 3,700 issues raised by tax agents were resolved.
- The March 2006 *Biannual tracking of tax agents' perception of service and usage of channels survey* indicated that the vast majority of surveyed tax agents agreed that the information received from us helps them deal with the tax system (over 90%) and that it is easier now than in the past to deal with the tax system (over 85%).
- 180 tax practitioners were placed on tailored lodgment programs where circumstances beyond their control caused a lag in their lodgment performance – for example, Cyclone Larry in far north Queensland.
- We continue to work with 130 practitioners to help them regain control of their lodgment obligations.
- This year over 80% of individual and trust tax level 6 returns (where the last year's return lodged showed a balance on assessment of greater than \$20,000) were lodged on time. This compares to 60% for the same taxpayer group last year.
- 150 unregistered tax agent cases were reviewed, with 10 of the cases being successfully prosecuted and further prosecutions pending; 30 have given undertakings that they will comply with the law.
- 260 registered tax agents were reviewed, with 140 of the agents being referred for review by a Tax Agents' Board or additional action by the Tax Office. 35 referrals to the Tax Agents' Board resulted in formal action, including formal warnings through to de-registration (12) and refusal to grant re-registration (9). A further 19 agents gave written undertakings that they have modified their work practices.
- 120 tax practitioners were prosecuted for lodgment offences.
- The Tax Agents' Boards:
 - cancelled 120 registrations
 - received 600 written complaints
 - referred 25 tax agents to us for investigation, and
 - suspended 13 tax agents.

Employers and other intermediaries

PROFILE

Intermediaries are people and organisations that help taxpayers meet their tax obligations, and help us monitor, review and improve compliance. Intermediaries such as employers, software developers, approved auditors of superannuation funds, financial planners, insolvency practitioners and organisations that provide us with information about taxpayers play important roles, and help create an environment that encourages high levels of voluntary compliance.

Intermediaries contribute to the operation of the tax system in many ways. For example:

- employers withhold tax and pay superannuation on behalf of their employees, and provide us with employees' tax information
- bodies such as banks, health insurance funds and government organisations provide us with transaction records and other information relevant to tax
- specialist tax software developers design and market record keeping and other software products that save taxpayers and tax agents time and money when preparing and lodging returns, activity statements and other information
- approved auditors of superannuation funds ensure that funds fully comply with their obligations, and report non-compliance
- financial planners provide advice about investments, including superannuation, and
- insolvency practitioners protect and maximise returns to all creditors, including the Commissioner of Taxation.

OUR GENERAL APPROACH

Our approach to intermediaries is shaped by the role they play in the revenue system. It includes:

- providing information and support tools – for example, to employers, software providers and financial planners
- using the information supplied by third-party data providers to monitor taxpayer compliance, and
- increasing compliance through
 - intermediaries, such as approved superannuation fund auditors and insolvency practitioners, or
 - our own monitoring of intermediary compliance, as is the case with employers.

HEADLINE ISSUES

Each year we revise our compliance focus to treat new, emerging and existing risks.

New and expanded priorities

In 2006–07 we are placing more emphasis on:

- improving the advice and support services we provide to help employers understand and comply with their administrative obligations, and
- expanding the range of information we obtain from third parties (while minimising the cost to them).

Continuing priorities

In 2006–07 we are continuing to focus on:

- making sure that employers comply with their administrative obligations
- supporting software developers to deliver products that meet user needs and the requirements of the law, and
- identifying and, where necessary, reviewing high-risk superannuation funds, using auditor contravention reports and other information.

EMPLOYERS

This year we are continuing to provide advice and assistance to employers, while monitoring their compliance.

Because they withhold and pay tax and report information on behalf of their employees, employers play a vital role as intermediaries in the revenue system.

In 2005–06 employers collectively administered about 45% of net Tax Office collections, in the form of pay as you go (PAYG) amounts withheld on behalf of their employees. Employers also have superannuation guarantee and fringe benefits tax obligations.

Although most employers fully comply with their tax obligations, non-compliance occurs where:

- tax management and record keeping practices and systems are inadequate
- cash flow is not well managed, and/or
- tax obligations are not well understood.

To improve compliance by employers, this year we are:

- reviewing cases where reporting appears inconsistent – for example, where PAYG withholding reported by an employer does not match the credits claimed by employees in their tax returns
- telephoning or writing to employers to seek clarification where their reporting under one obligation indicates they have not adequately reported under another obligation, and
- auditing businesses with deliberate or persistent inconsistencies or omissions to ensure they are complying with their obligations.

We are also collaborating with employer organisations to design information and tools to help employers understand and comply with their obligations. In particular, we are broadening the application of the online decision making tool that we launched in 2005–06 to help businesses in the building and construction industry apply the correct tax treatment to their contractors and employees.

Because they withhold and pay tax and report information on behalf of their employees, employers play a vital role as intermediaries in the revenue system.

THIRD-PARTY DATA PROVIDERS

We continue to use information from a range of third-party sources to verify information reported in income tax returns and activity statements, and to identify cases of non-compliance.

Information that organisations are legally obliged to provide includes:

- annual PAYG withholding payment summaries, from employers
- details of interest, dividend and unit trust distributions paid to investors from investment bodies
- details of payment and tax withheld amounts made to non-residents from payers of interest, unfranked dividends and royalties
- details about contributors, dependants and health cover for each person covered by a private health insurance policy from private health insurance funds and Medicare Australia, and
- details of welfare benefits from Centrelink, the Department of Veterans' Affairs and the Department of Employment and Workplace Relations.

Other information obtained from organisations includes:

- property data from state revenue offices
- share data from the Australian Stock Exchange and other share registries, and
- financial transaction information, including data on significant cash and suspect transactions and international funds transfers, from the Australian Transaction Reports and Analysis Centre (AUSTRAC).

We also exchange information with government organisations such as Centrelink, the Department of Immigration and Multicultural Affairs, and the Child Support Agency.

Under double tax agreements, we supply information to other countries about the income, including investment income, of overseas residents who pay tax in Australia. We also receive information from participating countries about income earned by Australian residents in their countries.

We will continue to receive, provide and process all information relating to taxpayers in accordance with strict privacy, secrecy and security guidelines. In obtaining the information we try to work with third parties to minimise their inconvenience and costs.

SOFTWARE DEVELOPERS

This year we will collaborate with more than 150 developers of accounting software and around 15 developers of electronic lodgment software to develop timely and effective products that meet the needs of a range of users, including the Tax Office, tax practitioners and taxpayers.

In particular, we continue to develop and promote a range of tools to help taxpayers lodge activity statements, returns and other forms online. Online lodgment reduces the likelihood of data entry errors, allows lodgment at any time of the day or week and provides immediate confirmation that information has been received.

This year we will also contact the developers of other new tax-related software packages and invite them to submit their products to be listed on our online register. The register lists commercially available tax-related software products – such as record keeping systems, payroll systems and calculators – that meet our accuracy requirements. Individuals and businesses, including tax practitioners, are increasingly using such products to help them manage their records and comply with their tax obligations.

APPROVED AUDITORS OF SUPERANNUATION FUNDS

This year we are continuing to consult and advise auditors of superannuation funds, and their professional associations, about specific cases and general compliance issues involving superannuation funds.

Approved auditors, supported by their professional associations, play a key role in influencing and assisting trustees of self managed superannuation funds to comply with their tax obligations. Through their independent audit activities, they:

- identify non-compliance issues
- inform trustees of ways to rectify non-compliance issues, and
- report contraventions to us.

Through their contravention reports, approved auditors help us identify cases for monitoring or review.

Where we have concerns about approved auditors whose performance demonstrates a failure to adequately perform their duties, we will refer them to their professional association for disciplinary or other action. In more serious cases, we may disqualify the approved auditor.

FINANCIAL PLANNERS

To help financial planners give their clients advice that does not pose a risk to tax compliance, this year we are continuing to:

- work with the Financial Planning Association and the Australian Securities and Investments Commission
- contribute information on technical topics to the Financial Planning Association online learning tool, and
- provide a range of education and support products for financial planners, including publications, product rulings and taxpayer alerts.

INSOLVENCY PRACTITIONERS

We continue to deal with insolvency practitioners in relation to all administrations in which the Commissioner is a creditor.

The Commissioner is usually an unsecured creditor, although if a garnishee notice has issued, the Commissioner is secured in relation to that notice. We rely on the expertise and professionalism of insolvency practitioners to protect and maximise the revenue collected, and to ensure any outstanding lodgments are brought up to date.

COMMISSIONER'S ADVICE

- If you have employees or contractors, www.ato.gov.au/employers has forms, tools and advice to help you meet your obligations.
- Investment bodies required to provide an *Annual Investment Income Report* can find information about the reporting requirements including news and updates at www.ato.gov.au/businesses
- Approved auditors of self managed superannuation funds can find information and advice at www.ato.gov.au/superprofessionals
- Information for developers of tax-related software is available at www.ato.gov.au/rsf
- Financial planners can check for product rulings at www.ato.gov.au/businesses Financial product information is also available at the Australian Securities and Investments Commission's website at www.fido.asic.gov.au
- Our website www.ato.gov.au/taxprofessionals provides quick and easy access to services and documents relevant to insolvency practitioners.

Online lodgment reduces the likelihood of data entry errors, allows lodgment at any time of the day or week and provides immediate confirmation that information has been received.