

CHAPTER EIGHT

SELF-ASSESSMENT AND RISK MANAGEMENT

Fundamentally, any tax system relies on people voluntarily meeting their responsibilities, otherwise you would be in a position where you would have to have a tax office with half the community looking over the shoulder of the rest of the community. It is a reality for all tax administrations. *Michael Carmody, Commissioner for Taxation.*

8.1 The ATO introduced self-assessment during the mid 1980s, overturning the previous system under which tax office staff checked each return. Self-assessment requires taxpayers to calculate their own liabilities using ATO guidelines, rulings and publications.

8.2 Self-assessment raises equity concerns if taxpayers do not consistently conform to self-assessment guidelines. The ATO uses three major compliance strategies to support the integrity of self assessment system:

- taxpayer education programs - to help taxpayers understand their obligations;
- the rulings system - to provide certainty where interpretation of the law may be uncertain or open to question; and
- audits of returns - to verify that taxpayers submit returns prepared in accordance with the law and ATO guidelines.

8.3 In common with all modern public sector organisations, the ATO must use its limited resources as efficiently as possible. Accordingly, the ATO increasingly employs risk management techniques, targeting audits and other compliance activity to areas where analysis suggests compliance may be poor. The Commissioner of Taxation explained:

Increasingly, this organisation operates on the basis of risk management. We identify areas of potential risk, such as the high wealth example we gave you, and then develop strategies to deal with that. Rather than under the old assessment system where everybody was required to provide everything, under our risk strategies, when we identify an area of the law - for example, international operations between related parties - then we will seek specifically further information in relation to those people so we can better hone and target our compliance strategies. That equally has benefits for the community because it means we are targeting our operations in the most appropriate way.¹

8.4 However, the ATO's approach to self-assessment system and risk management has its critics. These critics include some tax advisers within the financial services industry and some ATO staff who expressed their concerns on the *Sunday* program and to the Committee in evidence.

1 Evidence, p. 45.

8.5 In addition, a number of other sources expressed similar concerns about weaknesses with self-assessment. In particular, the evidence of witness Z and the report of Professor John Braithwaite on the HWI taskforce were relevant.

8.6 Criticisms of the ATO's approach to self assessment fall into several categories:

- "reverse" risk assessment - people judge that the ATO targets selectively and cannot check everyone and therefore evade tax on the basis that their chances of detection are acceptably low;
- the ATO relies excessively on risk assessment and does not take sufficient account of intelligence gathered by field staff;
- the ATO has failed to address known loopholes in the self assessment system;
- the ATO places too much emphasis on communication and education and does not devote sufficient resources to auditing returns; and
- auditing skills within the ATO are being eroded through the loss of experienced staff.

8.7 The final issue, the potential erosion of auditing skills through the loss of experienced staff, was an issue that emerged from a number of sources. This issue was raised by Professor Braithwaite in his report on the HWI taskforce; Mr Peter Haggstrom, who expressed concern about the implications for the ATO of the loss of experienced staff when interviewed for the *Sunday* program; in the evidence of witness Z and in the *Sunday* program.

Experienced staff and effective audit activity - Professor Braithwaite's view

8.8 Selective auditing of returns targeted through the ATO's risk analyses is an important compliance tool within the self-assessment system. Professor Braithwaite's study identified the importance of experienced and professional staff as a factor in effective audit activity. Braithwaite identified two important aspects to auditor training - technical skills (training the mind) and communication between staff with greater and lesser experience as a path to 'improving the wisdom of strategic audit judgement (training the nose)'.²

8.9 Professor Braithwaite saw experienced, capable auditors as having 'rare gifts' that should be actively retained within the organisation and passed on by the experienced to the less experienced:

Balance, an ability to extrapolate, the gift of getting an inkling on what a transaction means, and where it might lead, without the full information, are virtues that might be nurtured more by a retention program than by early retirement packages for people with these rare gifts. It perhaps can also be facilitated by the old and the wise conducting best practice workshops for the young who do not yet know how to read the commercial signs.³

2 Braithwaite, p. 15.

3 Braithwaite, p. 15.

8.10 Professor Braithwaite made three recommendations in respect of the HWI taskforce, aimed at retaining experienced and competent staff and bringing about cultural changes for disseminating skills. The taskforce indicated that it agreed with the recommendations and had taken steps towards their implementation.

8.11 The Committee considers that Professor Braithwaite's recommendations have broader application within the ATO and provide a model for improving the integrity of the self-assessment system beyond the HWI taskforce. Indeed, the Committee found Professor Braithwaite's discussion to resonate in several respects with that of a former ATO officer who gave *in camera* evidence.

The evidence of "witness Z"

8.12 Witness Z was a former ATO staff member with many years of experience. In the Committee's assessment, the witness was an officer of considerable integrity and commitment who possessed extensive knowledge of the ATO's operational environment.

8.13 In common with the concerns expressed in the report by Professor John Braithwaite, witness Z claimed that the loss of experienced staff handicapped the ATO's audit capabilities:

They are now finding that, in getting rid of the old hands who knew what was going on there, they are having problems, because the new people do not understand how it all works. You have to grow up in that culture to understand it. You just cannot bring someone in from outside and in five minutes irrespective of cranium capacity or qualification expect them to be able to do that sort of work. It just does not happen.⁴

8.14 The witness also argued that the ATO did not take sufficient account of local intelligence leads when deciding which taxpayers should be audited:

The auditing of salary and wage returns and/or individual non-business returns is generally set by the national office and does not take into account the specialised knowledge existing at all ATO offices on their patch. In other words, there are people in every office who know what is really going on but, generally speaking, they do not have an input into it.⁵

8.15 Witness Z contrasted audit results from locally selected audit targets with those selected by head office, claiming a considerably higher success rate:

As I said, the unit I managed averaged \$3,500 prime tax per audit compared with \$200 prime tax per audit for other INB clients... This anomaly did not come about by me being smarter than anybody else. It came about because I knew which areas to target in my area and what to look for. I knew my patch. Canberra did not choose my cases because of the sort of work I was doing.⁶

4 *In camera* evidence published by order of the Committee, p. 43.

5 *In camera* evidence published by order of the Committee, p. 38.

6 *In camera* evidence published by order of the Committee, p. 39.

8.16 Witness Z also raised a number of other issues about the self-assessment system. He claimed that there was considerable unchecked abuse of the system:

Self-assessment ... - we used to call it 'help yourself' - is failing the honest Australian taxpayers by allowing unscrupulous and dishonest persons to manipulate the system for their own gains, and they are generally getting away with this.⁷

8.17 The witness identified unregistered tax agents and fraudulent use of business losses as areas of significant revenue loss. The witness claimed that there are 'literally tens of thousands of these cases', expressing frustration about a lack of audit staff to carry out the audits necessary to identify the fraud and recover the revenue lost. He also claimed that the modern ATO is too sensitive to adverse publicity and is therefore unwilling to conduct site visits in order to verify claims: 'The office does not encourage people to go around and actually look at things and question things'.⁸

8.18 The Committee expresses its concern that the intelligence and experience contributed by committed officers such as witness Z sometimes appears to be overlooked or undervalued, and that they may be stereotyped as 'people who don't agree with change and its direction' or 'unable or unwilling to re-skill'.⁹ It is hardly surprising that these officers, well aware that certain individuals are not meeting their tax obligations, and perceiving that their advice is not valued, become disenchanted and leave the organisation.

8.19 In respect of the witness concerns about the lack of resources devoted to the auditing of small taxpayers, the ATO acknowledges that it no longer concentrates its resources in this area, relying extensively on automated systems such as income matching programs. However, the ATO is also clearly aware of the dangers of leaving even lower risk sectors of the taxpaying population unscrutinised:

It cannot be the case, though, that we completely ignore other areas. For example, the cash economy is a significant issue in the small business area. Someone from our large business area might validly say 'I could do more with on-offs in this cash economy if you gave it to me in large business'. You cannot ignore the cash economy because, left ignored, it would get worse than it is. We do not have huge programs in the individuals area...But again, if we just left that completely free, then unfortunately a lot of people would all of a sudden be doubling their deduction claims. While in the individual case that might not be a huge amount, multiply it by several million taxpayers and you have got an issue. So we have to balance our resources there.¹⁰

Conclusions

8.20 Self-assessment and associated risk assessment techniques cannot guarantee perfect collection of taxes that should be paid. However, the ATO argues that through the combined

7 *In camera* evidence published by order of the Committee, p. 38.

8 *In camera* evidence published by order of the Committee, p. 42.

9 Submission No. 83, p. 11.

10 Evidence, p. 299.

effects of taxpayer education, the evolving rulings system and increasingly well targeted compliance activities, it achieves relatively high levels of compliance.

8.21 The Committee did not pursue the issue of the ATO's management of risks within the self-assessment system to the extent that it is prepared to form conclusions about the matter. However, the Committee believes that further ATO investigation of possible threats to revenue posed by abuses of the self-assessment system is warranted.

8.22 Witness Z's evidence about the difficulties he encountered in obtaining sufficient resources to audit known trouble spots and getting other ATO officers to pursue identified probable evasion is of concern. It also relates to wider concerns that the ATO's computerised identification and audit techniques do not always detect to the same degree leakages that are identified by the field work of experienced operatives.

8.23 Professor Braithwaite's comments give further weight to the issues witness Z raised in evidence. In particular, the Committee notes Professor Braithwaite's views about the value of extended experience for auditors and the training role they could provide for less experienced staff.

8.24 In the Committee's view, experienced and committed "front line" officers like witness Z should be valued and retained where possible, and their experience and energies harnessed for the benefit of the organisation. The potential contribution of such officers to effectively targeting compliance activity should be acknowledged and utilised. It is unfortunate that so many of these experienced officers have apparently left the ATO in the large scale redundancy programs that have been in place for a number of years.

Recommendations

8.25 The Committee recommends that the ATO re-assess the effectiveness with which intelligence gathered by "front line" staff is integrated into targeting of compliance strategies.

8.26 The Committee further recommends that the ATO re-assess the effectiveness of retention and retraining programs for experienced officers and examine how their skills and experience might be better harnessed within the organisation.

