



Australian Government

Inspector-General of Taxation

Review into the ATO's use of benchmarking to target the cash economy

**Terms of Reference &
Submission Guidelines**

November 2011

BACKGROUND

1.1 In 2009, the Australian Taxation Office (ATO) established key ratios to compare the financial performance of taxpayers, with a turnover of up to \$15 million, against similar businesses in the same industry, often referred to as 'small business benchmarks'. To date the ATO has released benchmarks for more than 100 industries encompassing over 900,000 small businesses. Also, further benchmarks are planned for release in the coming year.

1.2 The ATO has stated in its 2011-12 Compliance Program that it has identified 46,000 businesses who may be under-reporting their cash income based on these benchmarks. The ATO has used these benchmarks in its cash economy compliance activities both as a risk assessment tool and as a basis for issuing default assessments since 2010.

1.3 Benchmarks are used as a risk assessment tool by the ATO to identify taxpayers who may be under-reporting income in their returns, particularly in relation to cash sales. Taxpayers who report income outside the relevant benchmark may be selected for compliance action by the ATO. Such taxpayers must provide documentation to the ATO to substantiate any shortfall.

1.4 Where the ATO is not satisfied with the reasons for a taxpayer's variation from the benchmark and their record keeping practices, the ATO has indicated that these benchmarks may be used to issue amended or default assessments to that taxpayer.

1.5 Concerns have been raised with the Inspector-General of Taxation (IGT) by taxpayers and tax agents about the ATO's use of small business benchmarks. In general, these concerns related to whether:

- a large number of compliant taxpayers are unnecessarily being targeted and thereby are being subjected to unnecessary compliance costs;
- the benchmarks adequately account for variations among businesses in the same industry, with some taxpayers expressing the view that no two business are alike;
- it is appropriate for the ATO to use these benchmarks as a basis to issue amended or default assessments or should the ATO, before taking such action, examine taxpayer specific information such as unexplained asset accumulation or personal expenditure; and
- the ATO's expectations in relation to small business record keeping are reasonable and clearly communicated.

TERMS OF REFERENCE

1.6 In accordance with subsection 8(1) of the *Inspector-General of Taxation Act 2003* (IGT Act), the IGT on his own initiative will conduct the following review:

The IGT will review aspects of the ATO's small business cash economy compliance activities with a focus on:

Risk identification

1. *The benchmarking process and its ability to identify under-reporting income by taxpayers, including whether:*
 - a. *compliant taxpayers are incorrectly captured;*
 - b. *imposed compliance costs are proportionate to the risks involved;*
 - c. *the ATO's underlying benchmark methodology, related data inputs and identification process are sufficiently transparent;*
 - d. *the ATO takes into consideration any resulting taxpayer concerns;*

Differentiation

2. *The benchmarking process and its ability to take into account material differences between taxpayers in a given industry category, including:*
 - a. *different external business factors such as locality;*
 - b. *businesses providing multiple goods or services being inappropriately categorised in a single industry identification process;*
 - c. *business owner specific factors that may explain variances;*
 - d. *different business measures that govern the handling and recording of cash;*

Basis for amended or default assessments

3. *The fairness and reasonableness in using the benchmarking process as a basis for determining and issuing amended or default assessments, including:*
 - a. *circumstances in which the ATO issues assessments based on benchmarking data;*
 - b. *where business records are considered inadequate, whether the ATO uses other information or evidence to assess the profits of the business, for example unexplained assets accumulation or personal expenditure records;*
 - c. *difficulties that taxpayers and tax agents face in seeking to challenge these assessments (such as proving that they did not earn the alleged additional income);*
 - d. *approaches and reasons taxpayers and tax agents may have taken in settlement of these disputes both pre and post assessment;*

Record keeping

4. *The ATO's small business record keeping expectations, including whether:*

- a. *the record keeping requirements are appropriate, given the size, specific nature and resources of small businesses;*
- b. *alternative forms of evidence are acceptable in satisfying ATO expectations;*
- c. *public guidance and direct assistance provided to taxpayers and tax agents for record keeping requirements are adequate and sufficiently differentiated;*

ATO approach, processes and practices

5. *The ATO approach, processes and practices in conducting compliance action and audits involving small business benchmarks, including whether:*
 - a. *taxpayer compliance costs are minimised and voluntary compliance is promoted, by the ATO:*
 - i. *alerting taxpayers and tax agents to common record keeping and reporting errors and inviting them to voluntarily disclose any such errors;*
 - ii. *taking a considered approach to information gathering;*
 - iii. *undertaking careful review of taxpayers' affairs before proceeding to audit;*
 - b. *communication with small businesses by ATO staff is appropriate and timely, including notification of their rights and obligations as a taxpayer, the reason for the review or audit, the audit plan and the dispute resolution process;*
 - c. *ATO staff seek to understand the taxpayer's business;*
 - d. *ATO staff engage with taxpayers and tax agents to consider the facts and reasons for benchmark variance;*
 - e. *taxpayers and tax agents are given adequate time and opportunity to present facts and reasons for benchmark variance;*
 - f. *taxpayers and tax agents experience practical and administrative difficulties in seeking to challenge ATO staff decisions.*

SUBMISSION GUIDELINES

1.7 In connection with the above terms of reference, we are seeking taxpayer submissions which detail accounts of micro and small business taxpayers who have been subject to compliance activities (such as audits) involving the ATO's use of small business benchmarks. This may include audits in which the ATO indicated that the taxpayer was being audited because their reported figures were significantly outside the benchmarks for their industry segment.

- 1.8 We envisage that, broadly, your submission will be divided into two parts:
- (i) a detailed account of your experience with ATO audits involving the use of small business benchmarks; and
 - (ii) any opportunities to improve ATO approaches or processes.

1.9 Specifically, it is important to provide a detailed account of particular ATO practices and behaviours that, in your view, contributed to an unreasonable process and/or outcome. The IGT is also seeking examples of positive ATO practices and behaviours that contributed to the timely and effective resolution of the audit.

1.10 As far as possible, these practices should address the terms of reference above.

1.11 In investigating the ATO's use of small business benchmarks in compliance activities, it would be useful to provide a time line of events outlining your key interactions with the ATO including information requests, key correspondence, the issuing of interim findings, ATO amended assessments and penalties (if relevant) and the outcomes of any objections or appeals.

1.12 Your submission should also list alternative actions, practices or behaviours which, in your view, could minimise the adverse effects of these ATO compliance activities.

Lodgement

1.13 The closing date for submissions is 3 February 2012. Submissions can be sent by:

Post to: Inspector-General of Taxation
GPO Box 551
SYDNEY NSW 2001

Email to: benchmark@igt.gov.au

Confidentiality

1.14 Submissions provided to the IGT are in strict confidence (unless you specify otherwise). This means that the identity of the taxpayer, the identity of the adviser and any information contained in such submissions will not be made available to any other person, including the ATO. Sections 23, 26 and 37 of the IGT Act 2003 safeguard the confidentiality and secrecy of such information provided to the IGT – for example, the IGT cannot disclose the information as a result of an FOI request, or as a result of a court order generally. Furthermore, if such information is the subject of client legal privilege (or legal professional privilege), disclosing that information to the IGT will **not** result in a waiver of that privilege.