

# **Review into the ATO's small and medium enterprise audit and risk review policies, procedures and practices**

**Terms of Reference**

**April 2010**



## BACKGROUND

1.1 During the Inspector-General of Taxation's (IGT) work program consultations, representatives of small and medium enterprises (SMEs) and high wealth individuals (HWIs) raised a number of concerns with the Australian Taxation Office's (ATO) review and audit approaches.

1.2 These concerns generally related to taxpayers receiving fair and equitable treatment and not being unduly burdened with unnecessary compliance costs stemming from the wide scope of ATO information gathering requests, delays, commercial awareness and conduct of ATO staff and the quality of ATO engagement on technical issues.

1.3 Particular concerns were raised on the implications of certain ATO announcements made from late 2008. These announcements explained that as a result of additional funding from the Government<sup>1</sup>, the ATO would:

- expand its compliance activities to risk assess over a 4-year period all businesses with annual turnovers between \$100m to \$250 million<sup>2</sup>, and follow this work up with more reviews and audits; and
- increase its monitoring, reviews and audits of High Wealth Individuals (HWIs).

1.4 The ATO announcements raise a concern that unless certain compliance approaches are improved, this additional ATO compliance focus will significantly increase unnecessary costs and unmanageable workloads for taxpayers as well as creating unnecessary administrative costs for the ATO.

1.5 The ATO announcements show that it plans to increase resourcing of its compliance areas to man these additional compliance activities. However, there are concerns that the ATO may not have sufficiently resourced its technical areas (such as the Centres of Expertise and Tax Counsel Network) to adequately deal with the increased workload that these compliance activities may generate for the ATO's Law Sub-Plan.

1.6 The Inspector-General now seeks to establish whether there is substantiated evidence of these concerns.

1.7 In investigating these concerns, the IGT will review the relevant ATO files and may interview ATO staff to identify the reasons for the ATO approaches, the steps the ATO took to minimise adverse outcomes for taxpayers and identify potential improvements.

---

<sup>1</sup> In the 2008 and 2009 Federal Budgets, the Government allocated an additional \$559 million of funding to the ATO for the purpose of enhancing the ATO's compliance activities and management of known tax risks in relation to the large business and high wealth individual market segments. This additional funding will be provided over the period 2008 to 2013 and is expected to increase Government revenues by \$3.28 billion. Only part of this additional funding relates to the ATO's increased compliance focus on SMEs and HWIs.

<sup>2</sup> The ATO previously categorised these businesses as 'large businesses'. However, the ATO has recently re-categorised these businesses as 'small and medium enterprises'.

## **TERMS OF REFERENCE**

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

*The IGT will review aspects of the ATO's compliance approaches to determine whether compliance activities of SMEs with annual turnovers between \$100 million and \$250 million and HWIs are being handled so as to promote their timely, efficient and fair resolution.*

*The IGT will also identify opportunities for improvement.*

*The review will have a particular focus on the ATO's:*

### *Resourcing*

1. *the extent to which the ATO has resourced its compliance and law sub-plans to deal with the intended increase in compliance activities in relation to these taxpayers, including:*
  - a. *whether the ATO auditors have the appropriate technical skill level and appropriately understand the commercial environment in which the taxpayer operates (such as, the effect that non-tax law has on the relevant industry);*
  - b. *whether the ATO has allocated enough senior technical resources (such as in the Centres of Expertise and Tax Counsel Network) for any increased workloads that its increased compliance focus may generate;*

### *Information gathering*

2. *in light of the limited resources that taxpayers in this market segment may be able to allocate for tax and other regulatory compliance, the extent to which the ATO ensures the exercise of its information gathering powers, both formally (such as s.264 notices) and informally, is being used appropriately and effectively (such as, the extent to which the ATO targets its information requests, minimises the potential for immaterial or duplicated information requests and explains the reasons for needing such information);*
3. *the extent to which asymmetry in timeframes for the ATO's and taxpayers' responses impact on taxpayers' costs — for example, the time periods that taxpayers have to respond to ATO information requests and the time periods that the ATO may take in considering and following up on those taxpayer responses;*

### *Compliance decisions*

4. *the extent to which the ATO ensures that its initial compliance decisions are accurate, including:*
  - a. *whether initial compliance decisions (such as penalties and primary tax liabilities) appropriately consider the evidentiary, specialist tax technical and commercial (e.g. valuations) issues, appropriately consider the relevant burden of proof, and minimise perceptions that they are used to establish an unfair advantage during negotiations;*
  - b. *whether allegations of evasion have an accurate evidentiary basis and are not used to audit or review issues which would otherwise be out of time in a self-assessment regime or for any other purpose;*

5. *on the same material facts, the extent to which ATO provides reasons for changes in views expressed throughout the audit and dispute process (for example, where the views expressed in the objection and/or appeal stage change from the initial audit stage) and minimises the impact on taxpayers' compliance costs where those views change;*

#### **Technical issue management**

6. *whether the ATO's conduct of compliance activities promote an appropriate and timely narrowing and/or resolution of issues in dispute, including:*
  - a. *whether there is sufficient initial prioritisation and scoping of issues for examination in the compliance activity to ensure that the highest risks to the tax system are examined and unnecessary compliance costs minimised;*
  - b. *the extent to which the conduct of compliance activities promote a timely understanding of the strengths and weaknesses of each parties' case (such as whether the ATO provides sufficient time for taxpayers to test the factual and evidentiary basis for proposed ATO compliance decisions or position papers) and makes timely decisions on the appropriate resolution of cases;*
  - c. *ensuring that ATO auditors follow the ATO's internal technical decision making processes (such as, applying precedential ATO views and citing their sources);*
  - d. *whether the ATO ensures that there is no inappropriate resistance to engaging in dialogue over technical issues (such as face-to-face access to technical decision-makers or technical advisers);*

#### **Project management and compliance activity conduct**

7. *the extent to which the ATO ensures sufficient project management of compliance activities and appropriate conduct in compliance activities, including:*
  - a. *whether project plans are appropriately developed (such as providing an opportunity to comment on expected timeframes and milestones), communicated to taxpayers (such as the initial project plan, the progress and finalisation of the compliance activity), monitored and complied with;*
  - b. *the extent to which taxpayers are negatively impacted by relevant ATO staff being located in different geographical location or changes in ATO audit personnel;*
  - c. *the extent to which the ATO makes appropriate and effective use of taxpayers' advisers in the management of the compliance activity;*
  - d. *the extent to which the ATO clearly and consistently communicates the commencement of the compliance activities (such as the when an 'audit' starts for taxpayer voluntary disclosure purposes and whether there is a consistent ATO approach to 'full and true disclosure') and the finalisation of those activities;*
  - e. *whether the ATO appropriately deals with claims of client legal privilege (or legal professional privilege) and the accountants' concession; and*
  - f. *whether ATO practices facilitate clear accountability, and a clear escalation pathway, for compliance activity conduct/practices/behaviours that cause taxpayer concern.*

1.9 In connection with the above terms of reference, we are seeking taxpayer submissions which detail accounts of SME and HWI experiences in dealing with ATO compliance activities, such as audits and risk review products. This would greatly assist us to identify potential systemic issues and allow us to examine these more efficiently and effectively.

1.10 We envisage that, broadly, your submission will be divided into two parts: a detailed account of your experience with ATO compliance activities; and, any opportunities to improve ATO compliance activities.

1.11 Specifically, it is important to provide a detailed account of specific ATO practices and behaviours that, in your view, impact upon the timely, efficient and effective resolution of an audit or risk review. Additionally, the IGT is also seeking examples of positive ATO practices and behaviours that contributed to the timely resolution of an audit or risk review.

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

1.13 In investigating the ATO's audit and risk review practices and related behaviours, it would be useful to provide a time line of events outlining your key interactions with the ATO including information requests, key meetings, the issuing of position papers and ATO amended assessments (if relevant).

1.14 Any adverse or detrimental impacts of the ATO's audit and risk review practices and behaviours should then be set out and, if possible, the costs quantified. These might include unanticipated tax liabilities raised in amended assessments (including tax, penalties and interest) for prior years, increased compliance costs in dealing with the ATO directly during the audit or increased ongoing compliance costs thereafter and potential restructuring of significant commercial arrangements.

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

#### Lodgement of submissions

1.16 The closing date for submissions is 31 May 2010. Submissions can be sent by:

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

Email to: [sme@igt.gov.au](mailto:sme@igt.gov.au)

#### Confidentiality

1.17 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.