



Australian Government

Inspector-General of Taxation

ISSUES PAPER NUMBER 1

CONTEXT FOR SCOPING REVIEW



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CONTEXT FOR SCOPING REVIEW

Paper outline

1 At the time of the announcement of the appointment of the Inspector-General of Taxation, the Minister for Revenue and Assistant Treasurer, Senator the Hon Helen Coonan, asked the Inspector-General to:

- consult with taxpayer organisations to identify the main systemic tax administration issues and concerns facing taxpayers; and
- provide a report to the Government on these findings providing initial views on the possible priorities for the future work of the office of Inspector-General of Taxation in helping the Government to address these concerns.

2 As a result of the consultative processes to identify significant systemic issues, a number of potential review projects have been identified and are presented for further evaluation in Issues Papers 3, 4 and 5. A comprehensive listing of parties consulted appears at **Appendix A**.

3 These Issues Papers cover matters that have been drawn to the attention of the Inspector-General of Taxation to date. It does not purport to represent an exhaustive list of all issues that taxpayers have with tax administration in Australia, and it is proposed to publish further Issues Papers as matters are raised.

4 The Commissioner of Taxation was given an opportunity to comment on review topics, as required in Section 25 of the *Inspector-General of Taxation Act 2003* and as discussed below.

5 The short timeframe for this initial process limited the rigorous testing of issues raised by taxpayers and tax advisers. The fact that issues have been covered in these papers should not be construed as a finding that a problem exists.

6 The issues raised have been incorporated into a series of issue or discussion papers. Further community input will be sought to assist in quantifying and clarifying issues, and to assist in prioritising matters for an ongoing work program. Continuing community input to the work program will be welcomed.

7 To assist the community and Inspector-General in determining priorities for the work program, Issues Paper Number 2 has been published as a draft framework for assessing issues. Broad community feedback is also sought on the model.

8 This brief introduction frames the initial review process in the context of broad trends in tax administration. An overview of the Commonwealth tax system in Australia is at **Appendix B**. An overview of Australia's taxation administration systems is at **Appendix C**.

Taxpayers' systemic tax administration concerns

9 Many different tax administration concerns were raised in the course of this initial process and 60 systemic issues are summarised in the Issues Papers.

10 Behind these systemic tax administration matters are some broad themes of taxpayer unease. These themes include:

- Apprehension about the **complexity** of the tax laws;
 - Including the lack of differentiation between large/small or high risk/low risk taxpayers; and
 - the differential tax treatment of capital and revenue items that creates significant compliance burdens;
- Concern that **over-engineered delivery** mechanisms have been developed for tax administration;
- Apprehension about the **capability** of tax administration officers, in both the private and public sector;
- Disquiet about the way in which **clarification of the tax laws** is achieved when taxpayers dispute tax administration decisions;

- Including through rulings and test litigation;
 - Anxiety about tax **debt collection** procedures and policies;
 - Disquiet about a **lack of commercial orientation** in aspects of tax administration;
 - Reflected in the time taken to finalise rulings and to settle claims for compensation for damage resulting from defective tax administration;
 - Uncertainty about what type or degree of **tax planning** constitutes illegal ‘aggressive tax planning’; and
 - Concern about the systems that the ATO has in place for **risk assessment** and **market intelligence**, associated with aggressive tax planning.
- 11 These broad themes underlie many of the systemic issues discussed later.

Increasing complexity of tax administration in Australia

12 There have been a number of catalysts for the establishment of the role of the Inspector-General of Taxation. One of the most obvious and important is the increasing complexity of tax administration in Australia – dating back to the 1980s – and the impact of this increasing complexity on taxpayers and tax practitioners.

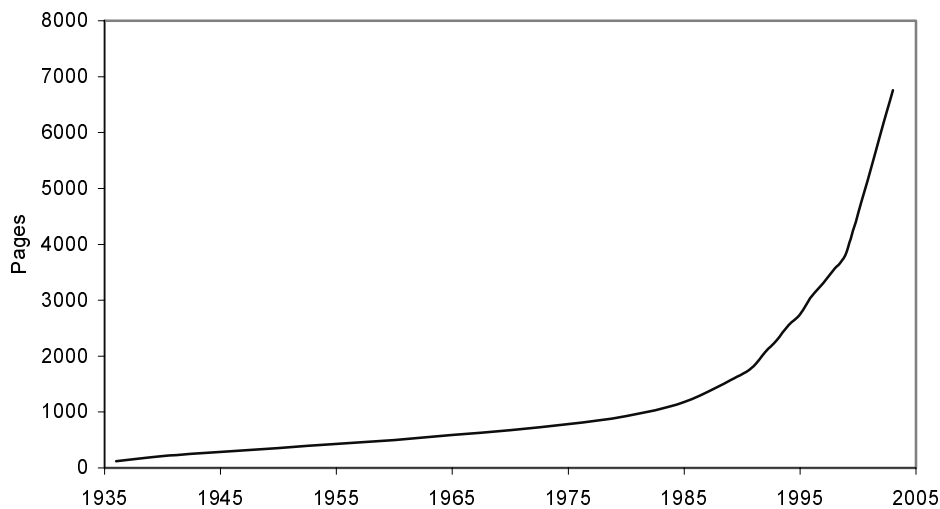
13 The tax professions (notably tax agents, accountants and lawyers) attribute much complexity in tax administration to a desire for ‘black letter’ legislation and broad anti-avoidance measures.

14 The increasing complexity of tax regulation – and the underlying reasons – were recently discussed by the Chairman of the Productivity Commission, Gary Banks, addressing a conference of economists on regulation in Australia.¹ Noting that the Income Tax Assessment Acts (both the 1936 and 1997 Acts) are now 60 times longer than when the original Income Tax

1 Gary Banks, Chairman, Productivity Commission, ‘The good, the bad and the ugly: economic perspectives on regulation in Australia’, Address to the *Conference of Economists, Business Symposium*, Hyatt Hotel, Canberra, 2 October 2003 p. 4.

Assessment Act was introduced in 1936 (as illustrated in Chart 1), he speculated that, if this rate of growth was maintained, these Acts could amount to 830 billion pages by the end of the century, requiring three million years of continuous reading to assimilate. While obviously unrealistic in a future sense, this does demonstrate the rate of change over recent times

Chart 1: Growth of the Income Tax Assessment Act(s)



Source: Gary Banks, Address to the *Conference of Economists, Business Symposium*, 2 October 2003, p. 4.

15 Gary Banks warned against regulatory complexity being seen as “something ‘done to us’ by naïve or incompetent regulators” noting that:

There is of course a reason for the increasing regulatory detail and complexity – us. Regulations that limit choice or impose costs on people invite evasive responses as much as compliant ones, sometimes more so. Hence the endless quest for tax loopholes (and the commensurate growth of tax consulting services) and the inevitable page-lengthening defensive responses by government.²

16 Gary Banks suggested that complexity in the tax laws should be seen as part of a strategic environment.

² Gary Banks, Address to the *Conference of Economists*, 2 October 2003, p. 3.

17 The strategic environment of tax administration, and, in particular, increasing conflict between the compliance strategies of the Australian Taxation Office (ATO) and the tax planning strategies of taxpayers, has been another catalyst for the establishment of the Inspector-General of Taxation. This conflict is discussed below.

Balancing individual and national interests

18 The Explanatory Memorandum to the Inspector-General of Taxation Bill 2002 observed that improving tax administration for all taxpayers involves balancing competing interests, including where simplifying tax administration for some taxpayers could prejudice efficient revenue collection to the detriment of the taxpaying community as a whole.

19 In tax administration, there is an inherent tension between the interests of individual taxpayers and the need to protect the revenue for the benefit of the community as a whole.

20 This tension was evident throughout the consultative process, with taxpayer advocates arguing that the complexity, inflexibility, and onerous compliance burden of current tax administration systems flow from an undue focus on protecting the revenue.

21 It is important to recognise that the Commissioner of Taxation and his staff are not personally responsible for all of this tension. The perception, encountered in the process, that there is an ongoing battle between taxpayers and the ATO, may arise in some cases because the ATO is the intermediary between taxpayers and a complex tax system. Taxpayers' real concerns may be with tax design, but the point at which they realise the difficulties that confront them in complying with tax laws is when they need to deal with the ATO.

22 Behind the scenes in the tax design process, many different Commonwealth agencies, Government advisers and community advocates have had a hand in formulating tax proposals and tax legislation. The ATO is not solely, and perhaps not at all, responsible for the tax laws it implements. Sometimes tax laws are not framed in a way that facilitates simple tax administration procedures, because of a need to tradeoff simplicity to achieve other policy imperatives.

23 The Issues Papers cover 60 potential reviews that could be undertaken by the Inspector-General of Taxation. Some of these would involve an examination of the laws underpinning systemic administrative issues. These reviews could result in recommendations for changes to the law, not just changes to ATO systems.

Tax minimisation

24 The tension between individual and collective interests is seen most starkly in cases where some taxpayers seek to minimise their tax liabilities. Since Australia has strong anti-tax-avoidance provisions in the tax laws, the question then arises as to where to draw the line between legitimate tax planning and illegitimate 'tax avoidance'.

25 Most taxpayers seek to avoid paying unnecessary tax if they have options available to them. Indeed, the Government relies on 'tax aversion' to achieve desired behavioural changes in the community. For example, the aim of the Medicare Levy surcharge on high-income earners who do not have private medical insurance was to encourage the take-up of private health insurance, not to raise revenue. Clearly, taxpayers who avoid the surcharge by taking out private health insurance are not to be regarded as 'tax cheats'.

26 In 1936, the House of Lords upheld tax avoidance arrangements entered into by the Duke of Westminster. Lord Tomlin was of the view that: 'Every man is entitled if he can to order his affairs so that the tax ... is less than it otherwise would be.'³ This view was reflected in the Privy Council's first consideration of early anti-avoidance provisions in Australia's income tax assessment legislation in 1958, with Lord Denning suggesting that: 'In these days, when rates of tax are high, it is natural enough for a man to seek so to order his affairs that the tax attaching under the appropriate Acts is less than it otherwise would be.'⁴

27 These judicial decisions preceded the introduction in 1981 of the Part IVA tax avoidance provisions in the *Income Tax Assessment Act 1936* (ITAA 1936). In his Second Reading Speech for the Part IVA amending legislation, the then Treasurer, the Hon John Howard MP, recognised that there is no broad agreement on what constitutes tax avoidance:

³ *IRC v. Duke of Westminster* [1936] AC 1.

⁴ *Newton v. Federal Commissioner of Taxation* [1958] 98 CLR 1.

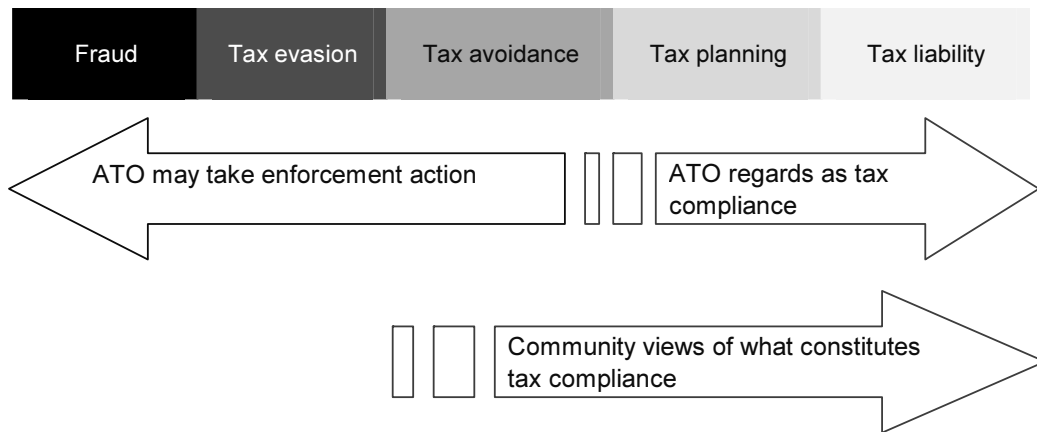
We are acutely aware that the term ‘tax avoidance’ means different things to different people.

Reasonable men and women are bound to differ on this crucial question and on the subsidiary matter of the appropriate tests for determining what behaviour a general anti-avoidance provision ought to proscribe.5

28 Community attitudes to tax planning change over time, becoming more or less accepting of tax minimisation arrangements. Examples include the previous ‘entity taxation’ or ‘taxation of trusts’ debate, and the current commentary on negative gearing of rental properties.

29 Where community attitudes and behaviour are closely aligned to the compliance policies of the ATO, tension is minimised. When community attitudes and behaviour are out of step with the compliance policies of the ATO, as illustrated in Figure 1 below, it is reasonable to expect a high degree of resistance amongst taxpayers. This is exacerbated if the tax laws or tax administration are seen to be unfair in that some people are able to take advantage of tax concessions simply by dint of better access to professional advice and advocacy.

Figure 1: Conflicting attitudes to tax compliance



30 An important function of systemic tax administration reviews will be to promote public debate and mutual understanding between taxpayers and tax officials on what constitutes ‘a fair thing’ in tax administration.

5 Hon John Howard MP, Treasurer, 2nd Reading Speech, Income Tax Laws Amendment Bill (No. 2) 1981.

Sharing the costs of tax administration

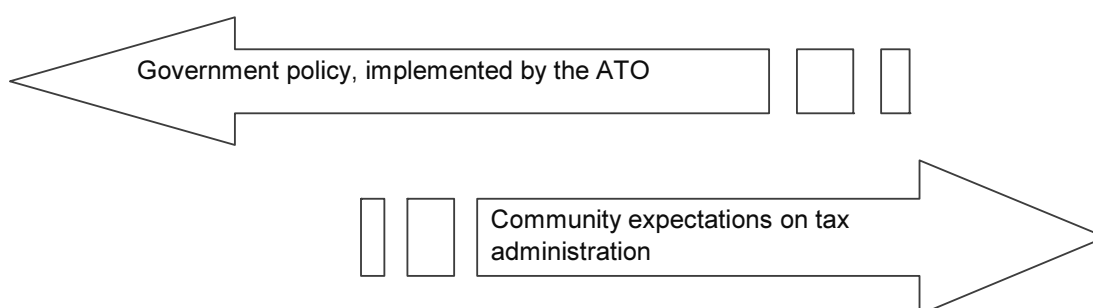
31 The divergence of views between taxpayers and the Commonwealth is not confined to tax planning. There is equal or greater concern about how tax compliance costs are allocated amongst taxpayers, their advisers and the ATO. A continuum of cost sharing arrangements is illustrated in Figure 2 below.

32 Amongst the tax advising professions, there is concern about the increasingly heavy tax compliance burden they seem to face. As the majority of taxpayers now rely on tax agents, their contribution to tax administration is crucial. They suggest their clients are not happy to pay professional fees for tax compliance tasks (as distinct from tax advice). Further, clients are not likely to be happy to pay for time that their agents spend negotiating with the ATO when an administrative mistake is made or there is a problem with the interface between ATO IT systems and agents' systems.

33 Some business groups argue that the tax system should factor in compensation to taxpayers and advisers for the costs of cooperating in the collection of the revenue and administration of the tax laws, quite apart from tax deductibility for the cost of managing one's own tax affairs.

Figure 2: Conflicting attitudes to sharing tax administration functions

Tax agents take increasing responsibility for facilitating tax collection	Taxpayers are responsible for self-assessing tax liabilities	ATO should provide advice through binding rulings and information products	ATO should assist taxpayers to meet tax obligations	Taxpayers and businesses should be compensated for the costs of compliance and revenue collection
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34 The issue of how tax administration and compliance costs are shared is also worth public airing and debate, the opportunity for which will arise in reviews.

35 A key challenge for the Inspector-General of Taxation will be to balance conflicting views on how to balance individual taxpayer interests with the broader national interest of protecting the revenue base and spreading the tax burden fairly. The policy framework proposed to achieve such balance is outlined in Issues Paper Number 2.

Consultation with taxpayer groups and tax advisers

36 The foundation of the initial work has been consultation with taxpayer groups, with tax advising professions, and with business groups.

37 Submissions to this process will not be published at this stage. Certain key submissions were lodged in confidence, and their publication is restricted under Section 26 of the *Inspector-General of Taxation Act 2003*. It would be inappropriate to attribute the broad range of views expressed in this report to a

subset of submissions that could be released publicly. The list at Appendix A includes all parties who were invited to make submissions, some of whom took up the opportunity and some of whom participated in meetings.

38 A three-stage approach to consultation was adopted. First, there were meetings between the Inspector-General of Taxation and key taxpayer groups, professional organisations and business groups in Sydney and Melbourne in late August. Second, 100 organisations were invited to lodge submissions on 25 August 2003. Finally, the Inspector-General of Taxation conducted breakfast and luncheon workshops in Perth and Brisbane with ‘focus groups’ of taxpayers and tax practitioners, to hear from a broad cross-section of people who deal with the Australian Taxation Office (ATO) on a daily basis.

Consultation with the Commissioner of Taxation

39 Section 25 of the *Inspector-General of Taxation Act 2003* gives the Commissioner of Taxation a right of reply before the Inspector-General can report any matters that are expressly or impliedly critical of the ATO.

40 The Commissioner of Taxation received advance notice of the issues that had been raised with the Inspector-General in submissions and meetings, via a summary of those issues provided to the ATO on Tuesday 7 October 2003. The Commissioner gave his preliminary comments on these issues on 14 October 2003.

41 The Commissioner was given a copy of the draft Issues Papers on 20 October and responded to the issues raised in that draft on 27 October. The Commissioner also met with the Inspector-General of Taxation on 27 October.

42 Many of the Commissioner’s specific comments on review topics have been incorporated in Issues Papers 3, 4 and 5.

Consultation with the Auditor-General

43 The Inspector-General of Taxation met with the Deputy Auditor-General and officers of the Performance Audit Services Group, Australian National Audit Office (ANAO) on 29 October 2003.

44 The meeting enabled a discussion of the respective independent roles of the Auditor-General (as an officer of the Parliament) and the Inspector-General of Taxation (as an adviser to the Government).

45 In 2003-04, the Auditor-General is undertaking, or is proposing to undertake, audits of:

- FarmBis, Farm Help and Farm Managements Deposits (includes ATO);
- ATO's management of Business Activity Statements;
- ATO's management of Aggressive Tax Planning;
- ATO's use of Investment and Income Reports;
- Internet-delivered government programs and services (includes ATO);
- ATO's administration of Superannuation Surcharge contributions;
- Taxpayers' Charter;
- Energy Grants Credits Scheme;
- ATO's administration of Taxation Rulings (follow-up);
- ATO's management of call centres;
- ATO's use of AUSTRAC data (follow-up);
- Non-taxation revenue estimates preparation and reporting (includes ATO);
- ATO's management of Tax File Number integrity;

- Business Authentication Framework (includes ATO);
- Financial Management and Reporting of Administered Special Appropriations (includes ATO); and
- (the reserve audit topic for 2003-04) Superannuation Guarantee (follow-up).⁶

46 While some of the above topics are covered in this report, the Inspector-General is not proposing to review any of these matters in 2003-04.

Consultation with the Taxation Ombudsman

47 The Inspector-General met with the Ombudsman on 28 October 2003.

48 The Taxation Ombudsman is currently reviewing the ATO's use of statutory search and entry powers.

Concluding introductory comments and thanks

49 The initial consultative process has been undertaken in a very tight timeframe. This has only been achieved with the cooperation and help of key stakeholders. Sincere thanks are extended to those taxpayer groups, tax practitioners, representatives of the legal profession, and business groups, who participated in meetings and workshops in August and early September, often on short notice. Those who prepared written submissions to this review made a particularly important contribution.

50 The Inspector-General of Taxation acknowledges with thanks the assistance of the Auditor-General and the ANAO. Thanks are also due to the Taxation Ombudsman and his Special Tax Adviser.

51 The Inspector-General of Taxation recognises the cooperation of the Commissioner of Taxation and his staff. The Commissioner hosted an information session on the ATO's corporate and compliance strategies for the Auditor-General, Taxation Ombudsman and Inspector-General of Taxation on 28 August 2003.

6 Australian National Audit Office, *Audit Work Program 2003-04*, July 2003, pp. 101-07.

52 The consultative process was conducted prior to the recruitment of the Inspector-General's permanent staff. The Inspector-General acknowledges with thanks the special contribution of Susan Johnston and Bradley Brown from the Treasury.

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Parties consulted during review

ACT & Region Chamber of Commerce & Industry

Administrative Review Council

Allens Arthur Robinson

Association of Superannuation Funds of Australia Ltd

Attorney-General's Department

Australian Bankers' Association

Australian Business

Australian Chamber of Commerce and Industry

Australian Consumers' Association

Australian Council of Social Service

Australian Finance Conference

Australian Industry Group

Australian Institute of Company Directors

Australian National Audit Office

Australians for Tax Justice

Australian Taxation Office

Blake Dawson Waldren

Business Coalition for Tax Reform

Business Council of Australia

Centre for Tax System Integrity, Australian National University

Parties consulted during review (continued)

Chamber of Commerce and Industry of Western Australia

Clayton Utz

Commerce Queensland

Corporate Tax Association

Council of Small Business Organisations of Australia Ltd

CPA Australia

Credit Union Services Corporation (Australia) Limited

Deloitte Touche Tohmatsu

Ernst & Young

Family Business Australia

Financial Planning Association of Australia Limited (FPA)

Financial Planners Association

Freehills

Institute of Chartered Accountants in Australia

Institute of Public Administration in Australia

International Banks and Securities Association of Australia

Investment and Financial Services Australia

KPMG Australia

Law Council of Australia

Law Institute of Victoria

Law Society of New South Wales

Parties consulted during review (continued)

Law Society of Tasmania

Law Society of the Australian Capital Territory

Law Society of Western Australia

Malleson Stephen Jaques

Minter Ellison

National Association of Community Legal Centres

National Association of Retail Grocers of Australia

National Farmers' Federation

National Institute of Accountants

National Tax and Accountants' Association Ltd

NSW Farmers Association

NSW State Chamber of Commerce

NT Cattleman's Association

NT Chamber of Commerce and Industry

NT Law Society

PricewaterhouseCoopers

Public Interest Advocacy Centre

Public Interest Law Clearing House

Queensland Farmer's Federation

Queensland Law Society Inc

Queensland Retail Traders and Shopkeepers Association

Parties consulted during review (continued)

Resolution Holdings

SA Council for International Trade and Commerce

SA Farmers' Federation

SA Law Society

Securities Institute

Small Business Coalition

Small Business Consultative Committee

Tasmania Chamber of Commerce and Industry

Tasmanian Farmers and Graziers Association

Taxation Institute of Australia

Taxation Ombudsman

Taxpayers Australia Inc.

Victorian Employers Chamber of Commerce and Industry

Victorian Farmers Federation

West Australian Farmers Federation (Inc)

Overview of the Commonwealth taxation system

The purpose of this section is to provide an overview of the Commonwealth taxation system, as well as on the collection of tax by revenue head.

Commonwealth taxation breakdown by revenue head

For the financial year ending 30 June 2003, the Commonwealth Government collected a total of \$163,055 million¹ in total tax revenue from taxpayers. This figure does not include an amount of \$30,699 million² in Goods and Services Tax (GST) revenue, as the GST is administered by the Commonwealth on behalf of the States and, as such, is treated as a State tax for budgetary purposes.

1 The 2002-03 Final Budget Outcome, Table 2, p 3.

2 The 2002-03 Final Budget Outcome, Note 15, p 50.

Table 1: Commonwealth taxes (2002-03 Final Budget Outcome)³

Commonwealth taxes (accruals)	\$m	Per cent of C'wth taxes
Income tax		
Individuals and other withholding ⁴		
Gross income tax withholding	84,640	51.9
Gross other individuals	18,314	11.2
less: Refunds	11,651	7.1
Companies	33,365	20.5
Superannuation funds		
Contributions and earnings	3,617	2.2
Superannuation surcharge	1,279	0.8
Petroleum resource rent tax	1,715	1.1
Total income tax	131,278	80.5
Indirect tax⁵		
Excise duty		
Petroleum products and other fuel products and crude oil	13,337	8.2
Other excise	7,450	4.6
Customs duty	5,573	3.4
Other indirect taxes	896	0.5
Total indirect tax	27,225	16.7
Fringe benefits tax	2,832	1.7
Agricultural levies and other taxes	1,690	1.0
Total Commonwealth taxes	163,055	100.0⁶

Table 1 shows that the major components of Commonwealth taxation revenue in 2002-03 were taxes on income (80.5 per cent of total taxation revenue), indirect taxes (16.7 per cent of total taxation revenue), fringe benefit tax (FBT) and other taxes (2.7 per cent of total taxation revenue)⁷.

³ The 2002-3 Final Budget Outcome, Table 2.

⁴ Inclusive of the Medicare levy.

⁵ Does not include \$30,699 million in GST revenue, paragraph 2 refers.

⁶ Percentages may not add to 100 as a result of rounding.

⁷ Note: Quoted percentages may not add to 100 as a result of rounding.

Chart 1: Commonwealth revenue collection by percentage

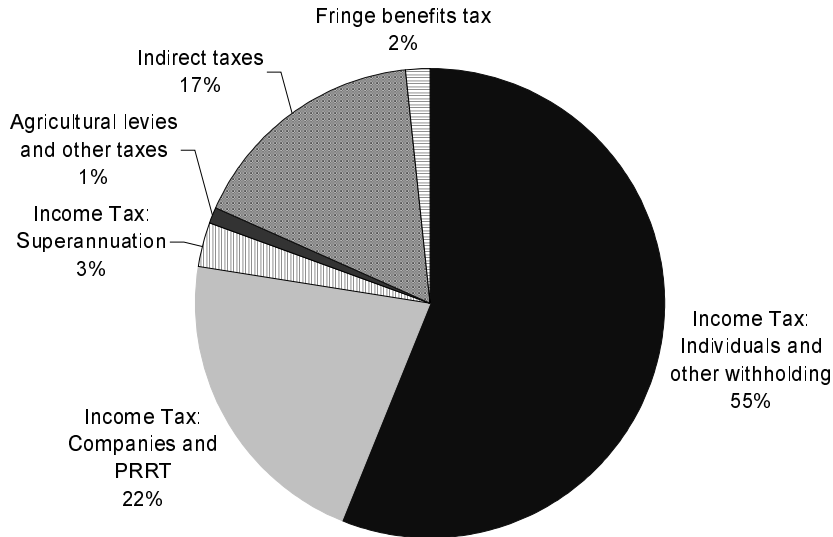


Chart 1 shows that income tax from individuals and companies was the major source of income tax revenue, with excise making up most of the Commonwealth indirect tax revenue. That is, 56 per cent from individuals (*including the Medicare Levy*), 21.6 per cent from companies (*including petroleum resource rent tax*) and 12.8 per cent from petroleum and other excises.

Historical overview of Commonwealth government taxes and revenue collection

Table 2 (below) provides a historical overview of taxation instruments introduced in Australia since 1800, ranging from the introduction of the first import duties through to the replacement of the Diesel Fuel Rebate Scheme and the Diesel & Alternative Fuel Grant Scheme with the Energy Grants (Credits) Scheme in July 2003.

Table 2 also provides an overview of Commonwealth Total Tax Cash Receipts from 1990-91 through to 2003-04, both as a total receipts cash figure and as a percentage of Gross Domestic Product (GDP).

Table 2: Historical Information

History of tax instruments	Date
First import duties	1800
Introduction of excise on spirits	1819
Excise and customs duties become preserve of Commonwealth under the Constitution	1901
Introduction of Commonwealth income tax	1915
Excise on petroleum and shale oil products (except diesel)	1927
Sales tax (set at 2.5 per cent)	1930
Income taxes ceded by States to the Commonwealth	1941
Introduction of PAYE tax system	1944-45
Excise on diesel	1957
Commonwealth passes payroll tax to the States	1971
Introduction of Diesel Fuel Rebate Scheme (DFRS)	1982
Introduction of CPI indexation of excise	Aug 1983
Introduction of petroleum resources rent tax	1987
Introduction of FBT	Sept 1985
Introduction of CGT	Sept 1985
Full imputation for company tax	July 1987
Gold mining tax exemption abolished	Jan 1991
Replacement of State BFFs with Commonwealth excise surcharge	Aug 1997
Introduction of CGT discount, abolition of indexation & averaging	Sept 1999
Introduction of tobacco per-stick excise arrangements	Nov 1999
Abolition of wholesales sales tax	July 2000
Introduction of GST	July 2000
Adjustment of fuel and alcohol excise rates for GST	July 2000
Introduction of Diesel and Alternative Fuel Grant Scheme (DAFGS)	July 2000
Abolition of fuel indexation	Mar 2001
Abolition of FID	July 2001
Abolition of stamp duty on share transactions	July 2001
Introduction of consolidation regime	July 2002
Introduction of National Excise Scheme for Low Alcohol Beer	July 2002
Replacement of DFRS & DAFGS with Energy Grants (Credits) Scheme	July 2003

Source: Smith, Julie P., (1993), *Taxing Popularity: The Story of Taxation in Australia, Budget Documents*.

Table 3: Commonwealth total tax cash receipts

	\$m	Per cent of GDP
1990-91	93,225	23.4
1991-92	87,970	21.6
1992-93	89,434	21.0
1993-94	94,024	21.0
1994-95	105,687	22.4
1995-96	116,386	23.1
1996-97	125,815	23.7
1997-98	132,219	23.6
1998-99	141,104	23.8
1999-00	150,695	24.0
2000-01	146,056	21.8
2001-02	147,544	20.7
2002-03	160,661	21.4
2003-04(a)	164,849	20.7

(a) Estimate.

Note: Figures up to and including 1998-99 are based on the old Commonwealth Budget Sector cash accounting framework. Figures from 1999-00 are on a Commonwealth general government GFS (cash) basis.

Source: Budget Paper No. 1, *Budget Strategy and Outlook 2003-04*, Statement 5; *2002-03 Final Budget Outcome*, Table C2.

This Appendix was prepared by the Australian Taxation Office at the request of the Inspector-General of Taxation to provide an overview of Australia's taxation administration systems.

OVERVIEW OF THE TAX ADMINISTRATION SYSTEM

Working with the community

1 The Australian Taxation Office (ATO) interacts with every sector of the community. Most adult Australians have contact with us at least once a year, when they lodge their annual income tax return. Each financial year around 10 million individuals lodge income tax returns with around 85 per cent getting a tax refund.

2 Businesses lodge activity statements either monthly or quarterly. Through these activity statements, businesses record and pay the GST they have collected, as well as other taxes.

3 Most Australians use a tax agent at some point for their tax affairs so tax agents play a critical role in the efficient operation of the tax system. Around 75 per cent of individuals and 97 per cent of business related income tax returns are lodged through agents. 55 per cent of activity statements are also lodged through agents.

4 To ensure effective interactions the taxpaying community is split into five segments:

Individual taxpayers

5 This segment is the largest group in the tax system and is made up of around 10 million people, mostly salary and wage earners. This segment contributes around 40 per cent of Commonwealth revenue.

Microbusinesses

6 There are around 2.5 million businesses with annual turnovers of less than \$2 million. They account for just over 10 per cent of Commonwealth revenue and around 60 per cent of the debt collected by the Tax Office.

Small to medium enterprises

7 There are around 108,000 businesses with an annual turnover between \$2 million and \$100 million. They account for around 10 per cent of Commonwealth revenue.

Large business

8 In the large business segment there are around 1,400 large business groups and 650 high wealth individuals who (together with their families and business entities) control more than \$30 million in assets. The segment contributes approximately 17 per cent of Commonwealth income tax, 55 per cent of GST, 54 per cent of fringe benefits tax and 95 per cent of excise revenue.

9 This segment also includes around 460 superannuation funds which are required to comply with income tax and superannuation obligations.

Non-profit and government organisations

10 Only 170,000 of Australia's 700,000 non-profit organisations are in the tax system. This is because many non-profits are small groups such as sporting and recreational clubs which are run on a volunteer basis and are exempt from income tax and other taxes. However, the 30,000 largest non-profit organisations employ 8 per cent of Australia's workforce so their role is significant because they collect around \$5 billion of tax paid by their employees.

COMPLIANCE

11 The Australian Taxation Office recently released its Compliance Program for 2003-04.

12 That Program details the many compliance issues the Tax Office faces in managing Australia's revenue systems. It also details the ATO's responses to managing those issues.

13 The overall approach to compliance is twofold:

- to ensure strategies are in place to deter non-compliance.
- to maximise the number of Australians who choose to voluntarily comply and to do this, the ATO has strategies in place which make it as easy as possible for people to understand and meet their obligations, and

14 ATO responses are proportionate to what is found, including the firmest possible enforcement actions for those who deliberately set out to avoid their obligations.

2002-03 results

15 In releasing the 2003-04 program, the ATO also released a snapshot of the results of the 2002-03 Compliance Program.

16 The additional revenue collected in 2002-03 as a result of audit and other verification activities exceeded \$3 billion.

17 This was the direct revenue impact only. It does not include the deterrent effect of the extensive compliance presence reflected in the wide range of audit and other verification activities detailed in the 2002-03 results. It also does not include the revenue impact of the additional 3.3 million activity statements and 420,000 income tax lodgments that resulted from an extensive lodgment enforcement program.

18 Finally the \$3 billion in additional collections does not include the taxes and penalties raised that are subject to dispute.

19 In the large corporate sector, in excess of \$2 billion in tax and penalties raised in audits last year is subject to dispute. Final collections will depend largely on the resolution of disputes, some of which can take many years to resolve through the courts.

20 To illustrate the breadth of the ATO's responsibilities, the 2002-03 results snapshot also records the fact that 26 tobacco cutting machines, 58.8 tonnes of tobacco and tobacco leaf, and three illegal liquor stills were seized.

The compliance landscape

21 The ATO's 2003-04 Program is shaped by a number of compliance risks.

- The dynamic and volatile nature of the world financial and trading system which continues to demand the ATO's attention and resources. This is because of the inherent complexity of dealings and risks associated with transfer pricing and abusive use of tax havens.
- Tax planning is a key feature of any tax landscape. Maintaining the line between legitimate tax planning — no one has an obligation to pay more tax than is payable under the law — and planning ultimately designed to avoid taxes payable under the law, remains a challenge for all.
- The appetite to find ways to pay less tax and the propensity to profit from devising and promoting schemes to satisfy that appetite is an ever present risk to the revenue systems.
- Of concern are warning signs of aggressive tax planning techniques being used for GST purposes and in the emerging bartering sector.
- Work expense claims, such as car, travel, uniform, laundry and self-education expenses continue to rise at rates out of step with ordinary price increases.
 - Around 6.4 million taxpayers claimed \$9.4 billion last year, an increase of around 12 per cent on the previous year.
- Reflecting trends in the investment property market, an additional 60,000 rental property owners came into the tax system last year.
- Around 1.3 million taxpayers declared rental income of \$12.6 billion and claimed rental deductions of \$13.2 billion last year, both up 8 per cent on the previous year.
- Many more people are now managing their own superannuation funds. There are around 250, 000 DIY funds, with registrations growing at more than 2,000 a month.

- Serious fraud and evasion also remains an ever present risk, particularly with the rise of identity fraud as a more significant threat, not restricted to tax.
- The progressive withdrawal of cigarette manufacturers from the local tobacco leaf market increases the risks of illegal tobacco or chop chop as it is better known being sold on the black market.

Robust collections

22 Last year's collections as forecast in the May 2003 Budget were \$1.7 billion above the original budget forecast.

23 As detailed in the *Large business and tax compliance* booklet released in June 2003, growth in corporate tax continues to outstrip the growth in GDP.

24 Similarly, effective tax rates for large corporates, measured by tax payable compared to total income, profit, total expenses or total assets are all on an upward trend.

Additional compliance resources in 2003-04

25 Some 850 additional staff will be devoted to managing compliance in 2003-04 compared to last year.

26 The additional compliance resources will be devoted to both improving assistance programs and expanding audit and verification activities.

27 This year approximately one-third of the compliance budget will go towards the provision of advice and assistance, including marketing and education, while almost two-thirds will fund active compliance, including audit and other verification activities and debt and lodgment enforcement.

28 The full range of compliance activities these resources are expected to be devoted to over the coming year is detailed in the Compliance Program.

Governance issues

29 In releasing the *Large business and tax compliance* booklet, the role of boards of directors and good governance in relation to taxation was raised.

Appendix C: Overview of the tax administration system

30 The expectation is that large corporates will ensure appropriate oversight of systems for management and integrity assurance relative to the importance of various tax issues. This requires close management and scrutiny of material issues.

31 The ATO does not expect directors and CEOs to be experts in the fine detail of the many volumes of tax code.

32 At the same time, a failure of tax compliance can have significant financial consequences for corporations and their shareholders.

33 The *Large business and tax compliance* booklet is pitched at a common sense explanation of what will attract tax office attention and the features of arrangements the ATO can be expected to challenge. It should assist directors and CEOs to gain a reasonable understanding, and make reasonable enquiries on tax issues related to major transactions and compliance systems within their corporations.

34 One of the more fundamental issues for a board and CEO is to consciously decide the position it wishes to take on tax planning, rather than have it made for them by others.

35 What is clear from the 2003-04 Compliance Program is that many of these issues are just as relevant for many medium-sized businesses whose turnover is high but below the \$100 million threshold the ATO uses to classify large businesses.

36 The ATO will increase its focus on this segment by applying the sophisticated economic and tax performance analysis used in the large corporate segment, with preliminary analysis pointing to similar results.

37 820 detailed risk reviews are planned this year, with compliance action being determined by the results of those reviews.

38 Learnings and experience gained in managing large corporate compliance will be applied to better managing compliance in the medium-sized business market with ATO experts from large business sharing their experience and expertise with tax office people working in the small to medium market.

39 Preliminary results of work undertaken last year to assess levels of compliance confirm there are issues to be addressed in relation to governance with some do it yourself (DIY) superannuation funds. Part of the tax office's response is educational and will include continuing trustee education program, as well as providing advice through more than 100 planned seminars and presentations.

40 At the same time the ATO is reviewing identified high risk trustees, including those disqualified through bankruptcy, to ensure their appropriateness as trustees.

Serious fraud and evasion

41 The tax law provides administrative penalties as the usual response to non-compliance.

42 Clearly the court system could not cope with all cases of non-disclosure of income or over-claiming of deductions being brought before it. Dealing more firmly with the more serious cases of fraud and evasion through prosecution action is an option that will not be ignored.

43 In 2002-03 161 successful prosecutions resulted from the 167 cases brought before the courts and 67 prison sentences were handed down.

44 The courts have shown they take an extremely serious view of revenue fraud, with two to three-year-plus sentences not unusual.

45 Investigators dealing with aspects of serious fraud and evasion were recently brought into one team under new senior management arrangements. As well as trafficking in illegal tobacco, this 400-strong group will have a specific focus on credit fraud (related to the broader issue of identity crime) and on people attempting to operate outside the tax system. This latter work will build on recent experience with some barristers.

46 The ATO is examining the use of sophisticated data matching technology. Initial projects include continuing to examine a range of professional groups, including the legal, medical, accounting and architectural professions.

Appendix C: Overview of the tax administration system

47 Credit fraud involves the adoption of false identities to claim credits, whether through refunds claimed on income tax forms or false GST input tax credits claimed through activity statements.

48 The ATO already has systematic approaches to identify suspect refund or credit claims prior to them being paid.

49 Last year 88,500 high risk refunds or credit claims were checked prior to issue. These checks may involve telephone queries or field reviews. In some cases, third-party suppliers may be contacted to validate transactions resulting in claimed refunds.

50 In 2003-04 the ATO will conduct over 113,000 such checks.

51 The balance the ATO has to strike here is applying reasonable checks without unreasonably delaying refunds to typically small businesses facing cash flow issues.

52 Identification and investigation work after refunds have been issued is therefore another feature of work in this area. The ATO works in close partnership with law enforcement agencies, including the Australian Federal Police and the Australian Crime Commission, which has a specific reference on money laundering and revenue fraud.

53 Extensive data matching with Centrelink, the Department of Immigration and Multicultural and Indigenous Affairs and with Births, Deaths and Marriages data helps identify use of false identities, including the use of other people's identities.

54 The ATO is also actively working with other government agencies in developing whole-of-government approaches to proof of identity processes.

55 The growth of identity fraud as a community issue has raised issues about the integrity of the Tax File Number data base where the number of Tax File Numbers (TFN) built up over the years exceeds the taxpayer population.

56 Aided by funding from government, new data matching programs and the introduction of electronic Births, Deaths and Marriage data, the ATO has been undertaking a major program to verify and update the TFN Register.

57 In 2002-03 the ATO updated or removed 2 million Tax File Numbers.

58 To date that work has revealed little evidence of concern about fraud with excess TFNs being typically related to deceased taxpayers or taxpayers who have left Australia. Cases being reviewed for the possibility of fraud amount to only \$7 million in potential revenue at risk.

Making It easier to comply

59 Compliance management is not simply about audits, verification and enforcement. It is also about making it as easy as possible for people to comply.

60 One-third of the ATO's compliance budget is directed at provision of advice and assistance. This includes a wide variety of marketing and education programs, advisory visits for new businesses, seminars and responding to telephone and written enquiries.

61 Last year, for example, the ATO conducted over 41,000 advisory and new business service visits, responded to over 12 million telephone and counter enquiries, issued almost 14,000 private rulings and conducted over 900 bizstart seminars.

62 A little over 2 per cent of the ATO budget will be invested in a program of initiatives designed to support the easier, cheaper and more personalised initiative.

63 The recently released booklet *Making it Easier to Comply* outlines a three year program detailing how the ATO will provide easier, cheaper and more personalised services, information and advice.

64 Already the program has delivered personalised tax agents' portals with account and other details of their clients and improved phone services, notices and website. A small business portal is being tested.

65 Effective management of revenue systems is also about managing a complex set of relationships, differentiating treatment according to the compliance posture adopted by different taxpayers and working co-operatively with others who have a role in the operation of those systems.

Tax agents

66 The major role played by tax agents in the operation of those systems cannot be underestimated.

67 In recognition of the critical role of tax agents, much of the initial focus of the Easier, Cheaper, More Personalised Program has been on better supporting these professionals.

68 Long established forums such as the National Tax Liaison Group and the ATO Tax Practitioner Forum ensure tax agents can contribute to ATO administrative approaches.

69 Tax agents face a number of challenges in remaining abreast of the law in the face of a continuing raft of new legislative measures. This challenges us to rethink role in educating them about changes to the law.

70 At the same time, a number of ATO activities are directed at monitoring the overall tax performance of tax agents, both personal tax performance and practice integrity. This includes identifying trends in claims, income reporting and advice that, at a minimum, raises questions about the practices of some agents.

71 After three years of operation of the new tax system, the ATO is implementing a renewed focus on the systematic profiling of returns lodged by tax agents to better identify patterns and trends that may indicate less than acceptable tax return preparation by particular agents.

72 Apparent patterns of poor compliance or competency issues by particular agents, or a trend across agents, will result in appropriately tailored compliance and education activities. Tax agents may be advised where the ATO sees a trend, visits an agent, undertakes a specific audit program, or conducts a broader review of their tax practice management procedures and controls.

Conclusion

73 The purpose of publishing the Compliance Program and associated papers such as the *Large business and tax compliance booklet* is to be more accountable to the community by explaining the decisions made in applying the resources available to the ATO in managing compliance.

74 Equally, in publishing material about what the ATO sees and what it is doing about it, the ATO is seeking to influence decisions by people in their approach to meeting their obligations.

75 These publications will provide a platform for informed consultation and feedback from the community on ways that the ATO can further improve management of Australia's revenue systems.