



Australian Government
Inspector-General of Taxation

ISSUES PAPER NUMBER 2

POLICY FRAMEWORK FOR REVIEW SELECTION



ISSUES PAPER NUMBER 2

POLICY FRAMEWORK FOR REVIEW SELECTION

Recognising and striving for 'good' tax administration	1
Ensuring reviews are within the scope of the <i>Inspector-General of Taxation Act 2003</i>	5
Identifying the best agency to conduct a review	7
Prioritising the inspector-general's reviews	9

ISSUES PAPER NUMBER 2

POLICY FRAMEWORK FOR REVIEW SELECTION

1 The purpose of this paper is to outline the draft policy framework developed as a guide to selecting topics for formal review. The review selection criteria are in draft form to signal the need for the refinement of the criteria in consultation with stakeholders – including taxpayer groups, the tax advising professions and business groups.

Recognising and striving for ‘good’ tax administration

2 The statutory role of the Inspector-General of Taxation is to improve tax administration for all taxpayers. It will be important to have objective criteria against which tax administration – and improvements – can be assessed.

Traditional tax administration policy principles

3 There is no real difference between the principles of good tax policy and the principles of good tax *administration* policy, since tax administration is simply the way in which tax policy is rolled out.

4 The fundamental principles of tax policy are equity, efficiency and simplicity. Within these broad principles are important criteria such as certainty, transparency, neutrality, stability and integrity.

5 Over more than two centuries, there has been fundamental agreement on what constitutes ‘good’ tax policy. An extract from the dissertation on tax principles by the 18th Century economist, Adam Smith, is at Box 1 to demonstrate that fundamental views of what constitutes a good tax system are not driven by short-term trends.

Box 1: Adam Smith on tax maxims

- I The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.
- II The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. ...The certainty of what each individual ought to pay is, in taxation, a matter of so great importance that a very considerable degree of inequality, it appears, I believe, from the experience of all nations, is not near so great an evil as a very small degree of uncertainty.
- III Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it.
- IV Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state.

A tax may either take out or keep out of the pockets of the people a great deal more than it brings into the public treasury, in the four following ways.

First, the levying of it may require a great number of officers, whose salaries may eat up the greater part of the produce of the tax ...

Secondly, it may obstruct the industry [of] the people, and discourage them from applying to certain branches of business which might give maintenance and employment to great multitudes. While it obliges the people to pay, it may thus diminish, or perhaps destroy, some of the funds which might enable them more easily to do so.

Thirdly, by the forfeitures and other penalties which those unfortunate individuals incur who attempt unsuccessfully to evade the tax, it may frequently ruin them, and thereby put an end to the benefit which the community might have received from the employment of their capitals. An injudicious tax offers a great temptation to smuggling. But the penalties of smuggling must rise in proportion to the temptation. The law, contrary to all the ordinary principles of justice, first creates the temptation, and then punishes those who yield to it...

Fourthly, by subjecting the people to the frequent visits and the odious examination of the tax-gatherers, it may expose them to much unnecessary trouble, vexation, and oppression; and though vexation is not, strictly speaking, expense, it is certainly equivalent to the expense at which every man would be willing to redeem himself from it.

It is in some one or other of these four different ways that taxes are frequently so much more burdensome to the people than they are beneficial to the sovereign.

The evident justice and utility of the foregoing maxims have recommended them more or less to the attention of all nations.

(Extract from *An Inquiry into the Nature and Causes of the Wealth of Nations*, 1776, Book 5, Chapter 2, Part II 'Of taxes')

- **Equitable** taxes spread the tax burden fairly across the population.
 - It is important that a properly resourced tax administration underpins equitable tax laws by achieving high levels of compliance with those laws.
 - It is also important that tax administration itself is equitable in that it allows all taxpayers fair and equal access to information, advice, review mechanisms and other tax administration services.
- **Efficient** taxes do not skew resource allocation decisions across the economy, contributing to a strong, productive economy.
 - In the course of this review, business groups questioned whether Australia's tax system could be considered efficient while its complexity continues to divert vast amounts of accounting, legal and business expertise away from strategic management into routine tax compliance functions.
- **Simplicity** in tax design and administration involves minimising uncertainty and compliance costs for taxpayers.

6 The three basic principles of equity, efficiency and simplicity are considered to provide reliable and basic signposts for improving tax administration.

Taxpayer service standards

7 Another important measure of how well tax administration systems are operating is performance against service standards that reflect community needs and expectations.

8 The Taxpayers' Charter, developed in consultation with the community, and the associated performance measures used by the Australian Taxation Office (ATO), are indicators of the extent to which tax administration systems operate for the benefit of taxpayers.

Policy Framework for Review Selection

9 In due course, it may be appropriate to review the Taxpayers' Charter and the ATO service standards, as well as the methodology for measuring ATO performance against those service standards. However, these are not issues or concerns that have been raised in early consultations with taxpayer groups. Of greater concern to taxpayers is the extent to which tax officers uphold the Charter in practice.

10 In view of the ATO's recent public review of the Charter, and the Auditor-General's intention to examine this review and the ATO's performance against the Charter, it is not proposed that the Inspector-General of Taxation would examine the Charter in the immediate future.

Benchmarking

11 Australia's tax administration system can be benchmarked against international models on some performance standards and broader criteria such as compliance costs.

Implementation objectives

12 Tax administration systems can also be assessed in terms of how well they have 'delivered' on commitments and objectives of legislative reform.

13 The Board of Taxation has the role of conducting post-implementation reviews of tax legislation. The Board's work in this area could also be an important indicator of how well particular tax administration systems are operating in terms of their impact on taxpayers.

Ensuring reviews are within the scope of the *Inspector-General of Taxation Act 2003*

14 The *Inspector-General of Taxation Act 2003* provides for the Inspector-General to review all systems established by the ATO to administer the tax laws, including their information and communication systems.¹

15 In addition, the Inspector-General can review tax administration systems that have been established by the Parliament under tax laws.²

16 However, it is not the role of the Inspector-General to review tax policy and tax laws that impose taxes or set tax rates.³

17 The Inspector-General of Taxation has no power to direct the Commissioner of Taxation in the administration of the tax laws and cannot overturn any decision made by the Commissioner. Moreover, it would be unconstitutional for the Inspector-General to review the Commissioner's interpretation of the tax laws; this form of review is by its nature a judicial function and thus the preserve of the Courts.

18 The process of determining if a review falls within the statutory functions of the Inspector-General of Taxation is illustrated in Chart 1.

1 Section 7 of the *Inspector-General of Taxation Act 2003* delineates the functions of the Inspector-General. It must be read with the extended definition of 'tax laws' in Section 4 of the Act. The Inspector-General may review ATO systems that are not 'tax' systems in the ordinary sense of the word. This would include the ATO's administration of the Family Tax Benefit or Energy Grants Credits.

2 The Inspector-General can review tax laws to the extent that they deal with administrative matters such as the process for assessing, collecting, paying or recovering amounts under a tax law, or the enforcement of a tax law. (Sub-section 7(2))

3 The Inspector-General cannot review tax laws that include rules imposing or creating an obligation to pay an amount under a tax law, or rules dealing with the quantification of such an amount. (Sub-section 7(2))

Ensuring that tax administration is the real problem

- 19 All problems taxpayers encounter with the tax system are likely to have a tax administration angle.
- 20 However, if the most serious underlying problem is complexity in tax design, then reviewing peripheral administrative issues is not an efficient use of finite investigative resources.
- 21 If systemic tax administration problems cannot be remedied because of tax design constraints, the Inspector-General can draw this to the attention of the Government but will not conduct a review.

Identifying the best agency to conduct a review

22 The Inspector-General of Taxation is not the only Commonwealth agency reviewing the operations of the Australian Taxation Office (ATO), but has a highly specialised function to review systemic issues in tax administration and to advise the Government on improving tax administration for the benefit of all taxpayers. The Inspector-General's role is different from that of other agencies reviewing the operations of the ATO:

- First, the Inspector-General of Taxation **reviews administrative systems** and not individual complaints about ATO administration.
 - The Taxation Ombudsman retains the role of resolving individual taxpayer complaints.
- Second, although the Inspector-General's reports are published, including by tabling in Parliament, he **reports to the Treasury Ministers** with recommendations for the Government to act to improve tax administration.
 - The Ombudsman and the Auditor-General **report to the Parliament.**
 - The Auditor-General is an independent officer of the Parliament. Through the ANAO he provides an independent review of the performance and accountability of Commonwealth public sector entities.

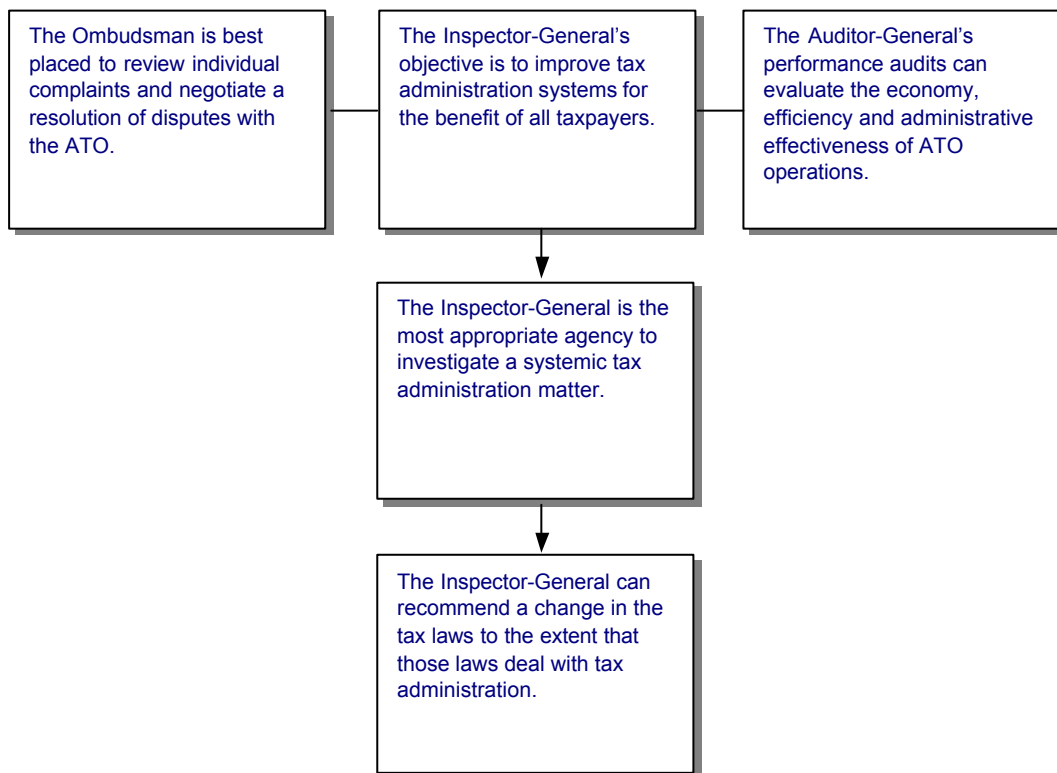
- The Inspector-General of Taxation is an **adviser to the Government**.

23 The *Inspector-General of Taxation Act 2003* recognises the importance of consulting with the Commonwealth Ombudsman and the Commonwealth Auditor-General at least once a year, to ensure the optimum allocation of Commonwealth resources to ATO reviews.

24 The process of allocating reviews amongst agencies is illustrated in Chart 2.

Chart 2: Identifying the best agency to tackle a tax administration problem

Section 9 of the *Inspector-General of Taxation Act 2003* provides that the Inspector-General must consult with the Ombudsman and Auditor-General in setting his work program.



Prioritising the Inspector-General's reviews

25 The most difficult stage of topic selection will involve allocating priorities to the different potential reviews into systemic tax administration issues.

26 The review selection process is illustrated in Chart 3. The rationale for this methodology is discussed below.

Improving tax administration for the benefit of all taxpayers

27 Section 3 of the *Inspector-General of Taxation Act 2003* provides that the principal objective is to improve the administration of the tax laws for the benefit of **all** taxpayers.

28 This is about making tax administration **more equitable, more efficient and simpler**.

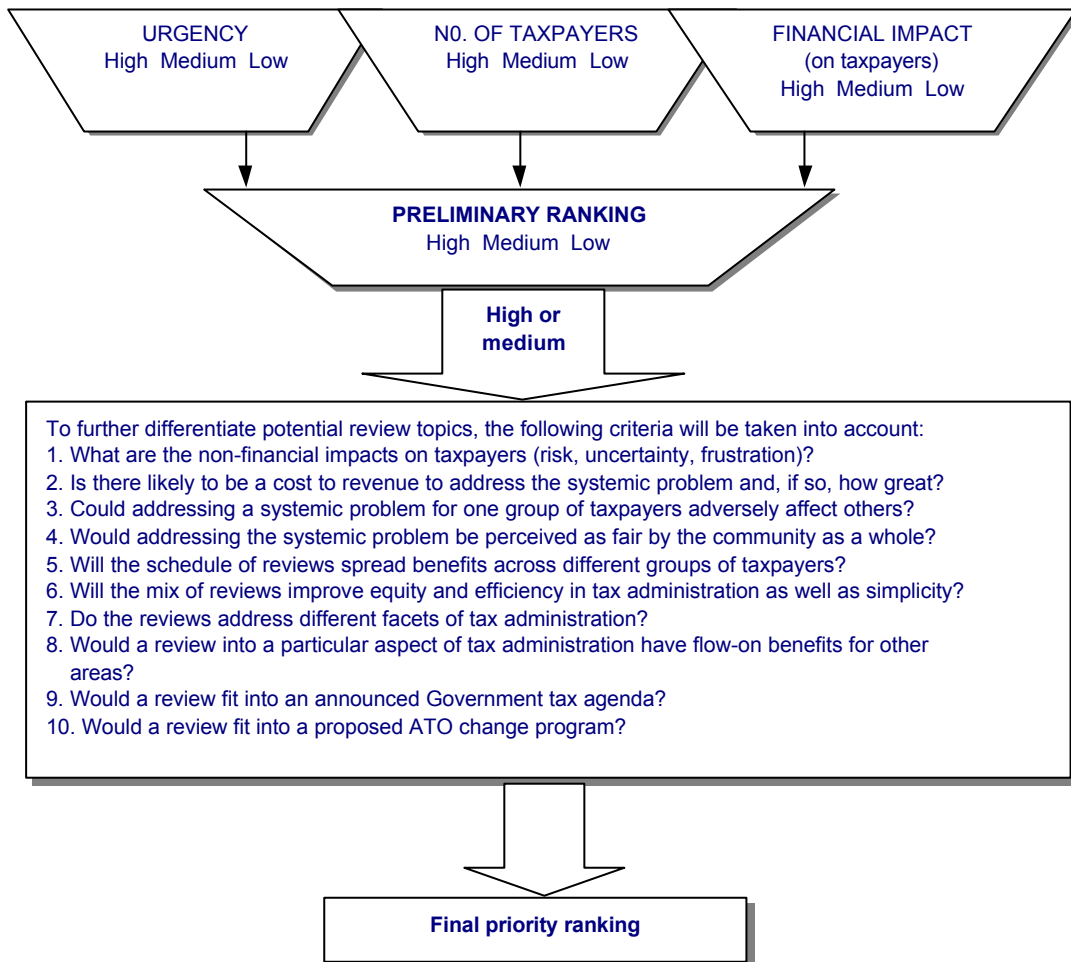
29 A simple scoring mechanism will not enable the proper ranking of review topics on their merits. At the same time, there is a need to avoid a review selection methodology that is so convoluted as to be incomprehensible to stakeholders who have a right to know how their concerns will be assessed.

30 It is proposed to adopt a two-stage process:

- First, there will be a raw measure of the 'taxpayer benefit' of a review based on the number of taxpayers affected by a systemic problem and the quantum of loss or damage resulting from the problem.
- Second, there will be a fine-tuning process involving consideration of policy criteria that do not lend themselves to simple measurement.
 - For example, non-financial loss and damage, including where taxpayers are subjected to risk and uncertainty, will be taken into account in the *second* stage of the review selection process.

Chart 3: Criteria for determining program of reviews

All requests for the Inspector-General to review a systemic tax administration matter (including requests from the Minister under Section 8(2) of the *Inspector-General of Taxation Act 2003*) will be rated.



Preliminary assessment of taxpayer benefit

31 The raw measure of the taxpayer benefit expected to result from fixing a systemic problem will involve measures of the number of taxpayers currently affected by a systemic problem and the total (dollar) amount of loss or damage they have suffered.

- The number of taxpayers affected is an actual, not a potential measure.
 - So, for example, if the systemic issue to be reviewed involved debt collection practices by the ATO when dealing with small businesses, the number of taxpayers affected:
 - : would **not** equal all small business taxpayers (who may or may not be subject to debt collection by the ATO in the future); but rather
 - : could be assessed as the number of small businesses currently in debt to the ATO, or the average number of small businesses who face debt collection procedures each year, based on figures for the last three years.
- Loss and damage will be broadly construed to include the total financial impact on taxpayers of a systemic problem.
 - Loss would include, for example, interest and penalties, excessive compliance costs and the opportunity cost of late refunds to taxpayers.
 - Damage will be broadly construed to include foregone opportunities, any negative impact on business operations, and collateral damage arising from a systemic problem with ATO administration.

Urgency

32 The first stage will also include an assessment of the urgency of a review – that is, whether fixing a systemic tax administration problem is time-critical. This could be the case if there are large numbers of taxpayers in immediate distress or hardship, and/or if there is an immediate threat to the viability of a tax administration system.

Refining the preliminary taxpayer benefit assessment

33 Once preliminary assessments have been made, the second 'cut' will involve consideration of how review topics rate against the following criteria.

34 Only those issues with high priority or medium priority rankings from the first 'cut' face second round assessment.

Non-financial costs to taxpayers

35 The financial costs of complying with tax laws are not necessarily taxpayers' most serious concern about tax compliance.

36 High levels of risk and uncertainty for taxpayers may be equally or more important. The tax laws expose taxpayers to very serious risks, including criminal sanctions. Indeed, taxpayers may incur additional costs for the specific purpose of minimising risk and uncertainty – such as engaging professional tax advisers – so that risk also has a financial cost.

37 Inconvenience and frustration, when Australians are increasingly 'time-poor', are also important considerations.

38 Finally, it is important not to underestimate the impact on taxpayers of processes such as debt collection and audit, nor to dismiss the distress caused to citizens who feel they are being treated as 'tax cheats'.

Revenue and equity implications of fixing a systemic problem

39 There are often trade-offs to be made in simplifying tax administration systems. The Explanatory Memorandum explicitly drew attention to the need to be cautious lest simplifying tax administration for *some* taxpayers prejudice efficient revenue collection to the detriment of the taxpaying community *as a whole*.

40 As a matter of course, information will be sought from the ATO to enable an assessment of the possible revenue implications of addressing systemic tax administration problems.

41 There will be a need to balance the interests of different groups of taxpayers (some of whom may be making representations to the Inspector-General of Taxation and others who are not) to maintain and promote fairness in tax administration.

Need for taxpayers to perceive the tax system as fair

42 Australia has a high level of tax compliance. The continued effectiveness and efficiency of tax administration will be dependent on Australians believing that they are being treated fairly. Recent research by the Centre for Tax System Integrity at the Australian National University suggested that most people (87 per cent of those surveyed) agreed that they will pay their fair share of taxes *as long as other people do*.⁴

43 There will be a focus on any systemic tax administration issues that are giving rise to broad community perceptions that tax administration is unfair, discriminatory, or unduly burdensome. There is also a need to guard against pursuing solutions to systemic tax administration problems where the community is likely to perceive those solutions as unfair.

Coverage of issues and stakeholder groups

44 To achieve the support of a broad range of taxpayer groups, the tax advising professions and business groups, it will be important that different groupings of taxpayers see action on topical and relevant matters. Consultation has been critical to the conduct of this first process, and will be critical for the future.

Flow-on benefits for other aspects of tax administration

45 In some circumstances, a review will have the potential to improve tax administration systems *other* than the system under review.

46 It is important that likely 'flow-on' benefits from a review be recognised. Accordingly, consideration will be given to whether improvements resulting from a particular review would easily transfer across business lines in the ATO or across different tax administration functions.

4 Centre for Tax System Integrity, June 2003 Tax Snap - Paying Taxes, from the *Community Participation and Citizenship Survey 2000* (survey run in NSW and Victoria), available at: <http://ctsi.anu.edu.au/tax.snaps.jun2003.doc>.

Policy Framework for Review Selection

Windows of opportunity

47 Ultimately, to improve tax administration for all taxpayers, it is important that the Inspector-General of Taxation has the support of the Treasury Ministers and/or the Commissioner of Taxation. He cannot direct the Commissioner of Taxation and can only influence the Government's tax administration policy through persuasion.

48 Accordingly, it will be important for reviews to 'slot in' to major Government tax reform processes, or to ATO change programs, whenever possible. There is also a need to ensure that there is no duplication in effort where tax administration matters are under review by the Government.

49 It will be particularly important to distinguish the investigatory and advisory role of the Inspector-General of Taxation from the policy development and implementation roles of other Commonwealth agencies.

50 Reviews will be scheduled to deliver recommendations to the Government and to the ATO at a time when recommendations can be most easily and quickly implemented.

Conclusions

51 The policy framework in this paper is provided for discussion and comment.

52 The final policy framework, developed in consultation with stakeholders, will shape review selection and the way in which stakeholders frame submissions to the office. In particular, it may focus stakeholder thinking about how reviews could improve the equity/fairness, efficiency and simplicity of tax administration.

Copyright

© Commonwealth of Australia 2003

This work is copyright. You may download, display, print and reproduce this material in unaltered form only (retaining this notice) for your personal, non-commercial use or use within your organisation. Apart from any use as permitted under the *Copyright Act 1968*, all other rights are reserved.

Requests for further authorisation should be directed to the Commonwealth Copyright Administration, Intellectual Property Branch, Department of Communications, Information Technology and the Arts, GPO Box 2154, Canberra ACT 2601 or by email to commonwealth.copyright@dcita.gov.au.