

The Parliament of the Commonwealth of Australia

# A TAXING PROBLEM

Review of 5 Auditor-General's Efficiency Audit Reports  
into the Australian Taxation Office

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Report from the House of Representatives  
Standing Committee on Expenditure

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September 1986

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THE COMMONWEALTH OF AUSTRALIA

DEPARTMENT OF EDUCATION AND SCIENCE

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# Foreword

This report is a review of 5 efficiency audit reports on the Australian Taxation Office (ATO) presented to the Parliament by the Australian Audit Office. I would like to thank the Members of the Sub-committee and the Committee secretariat for their contributions. In particular, on behalf of the Sub-committee, I would like to compliment Mr Greg Burgess, seconded from the Audit Office for our inquiry, for the considerable assistance he rendered in the preparation of this Committee report.

For many years the conventional wisdom has been that an increase in the staff resources of ATO will result in a more than proportionate increase in the amount of tax revenue collected. The efficiency audit reports have opened wide a different window. These reports, together with the Committee's investigations, show quite clearly that improved management practices, particularly the modernisation of ATO's automatic data processing facilities and the development of priority setting mechanisms, together with the examination of the effectiveness and cost-effectiveness of alternative tax collection systems (e.g. a withholding tax on interest paid) could increase, very substantially, the amount of tax collected from the existing tax base by improving taxpayer compliance.

These are significant findings indeed. For perhaps over a decade, governments have encountered difficulties in managing the economy. It is no exaggeration to say that matters such as the extent of and financing of the deficit and the size of the public sector would have been easier to handle if there had been greater taxpayer compliance brought about by efficient administration of the tax laws.

This review report brings to the attention of the Parliament, the Government and the community, what can be termed a certain 'malaise' in the administration of our tax laws. We urge the Government to give prompt attention to our report and to respond to our recommendations early in the 1987 Autumn sittings.

On 24 August 1983 the Senate was informed that the Government would respond to reports from parliamentary committees within 3 months of presentation. A substantive response, rather than the reporting of progress in the preparation of a response, is what the Committee expects and looks forward to.

**Ian Wilson, MP**  
**Sub-committee Chairman**

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Secretary: Mrs S.M. Harlow (until 1.9.86)  
Mr M.E. Aldons (since 8.9.86)

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# Recommendations

The Committee recommends that:

(1) The Australian Audit Office follow a more positive approach in its reporting by providing, in particular, detailed constructive recommendations and advice to audited agencies in cases where serious deficiencies within an agency's activities are observed.

(Paragraph 2.9)

(2) A summary of findings detailing the Australian Audit Office's findings and recommendations be included in all future efficiency audit reports.

(Paragraph 2.10)

(3) The Australian Audit Office include time targets for implementation of its efficiency audit recommendations and indicate priorities among these recommendations, such time targets to be set after consultation with departments and authorities subject to efficiency audits.

(Paragraph 2.13)

(4) The Australian Audit Office be given, on a timely basis, a copy of all quarterly reports sent to the Minister for Finance concerning implementation of recommendations in efficiency audit reports.

(Paragraph 2.23)

(5) The Australian Audit Office advise the Parliament at the first available opportunity of deficiencies in the implementation of efficiency audit recommendations.

(Paragraph 2.23)

(6) The Department of Finance actively follow-up the comments made by the Auditor-General and keep the Parliament informed

by reporting regularly to the parliamentary committees that examine efficiency audit reports.

(Paragraph 2.23)

- (7) The Government establish a Joint Management Review to investigate the overall performance and operation of the Australian Taxation Office and inform the Parliament of the outcome of the review.

(Paragraph 2.29)

- (8) Commencing immediately, the Australian Taxation Office develop adequate priority-setting mechanisms detailing areas that they consider require examination and that this mechanism and identified areas be outlined in ATO's annual report indicating the progress achieved at subsequent intervals.

(Paragraph 2.29)

- (9) The Australian Taxation Office, as part of the proposed priority-setting mechanism outlined in Recommendation 8, detail in its annual reports the progress of staff numbers transferred from technical assessing duties to compliance areas such as field or in-house auditing activities.

(Paragraph 3.6)

- (10) In implementing its 1985 ADP Strategic Plan the Australian Taxation Office (ATO):

(a) give priority to improving its income detection capability; and

(b) examine the need for information supplied to it under Income Tax Regulation 11(2) to be compatible with systems in ATO and advise the Government accordingly.

(Paragraph 3.20)

- (11) The Australian Taxation Office establish a regular review and reporting mechanism in regard to its actual and proposed ADP operations; this mechanism to be along the lines suggested in Recommendation 8.

(Paragraph 3.33)

- (12) As a matter of urgency, the Australian Taxation Office advise the Government on the effectiveness and cost-effectiveness of a withholding tax on interest paid to Australian residents by all companies and financial institutions, including the Reserve Bank of Australia.  
(Paragraph 4.19)
- (13) The Australian Taxation Office undertake a study of the effectiveness and cost-effectiveness of alternative tax collection systems (with particular emphasis on a generalised withholding tax structure) and advise the Government accordingly.  
(Paragraph 4.20)
- (14) The review of the Prescribed Payments System (PPS) announced by the Treasurer in his September 1985 statement be expedited and the report be presented to the Parliament soon after the completion of the review.  
(Paragraph 4.26)
- (15) The review referred to in Recommendation 14 include an examination of the effectiveness and cost-effectiveness of the current operation of the Prescribed Payments System.  
(Paragraph 4.31)
- (16) The Australian Taxation Office examine alternatives to current salary and wage compliance activities, including a review of stricter disclosure requirements for Income Tax Instalment Declarations and advise the Government of benefits and costs of various options available to minimise tax revenue loss in this area.  
(Paragraph 4.39)
- (17) The Australian Taxation Office seek from the Attorney-General's Department advice as to whether the late publication on 5 July 1983 of a Commonwealth Gazette notice required under Income Tax Regulation 54DAG, legally revived Income Instalment Declarations furnished prior to 1 July 1983 for the purposes of determining the amounts to be deducted as tax instalments during the 1983-84 financial year.  
(Paragraph 4.42)

(18) With or without the adoption of the Australia Card, the Australian Taxation Office take the necessary steps to establish a high integrity identification system which would ensure maximum taxpayer compliance.

(Paragraph 4.48)

(19) In view of the introduction of self-assessment, the Australian Taxation Office (ATO) implement a taxpayer flagging and reporting system so as to allow taxpayers to highlight certain items within their returns where uncertainty exists for attention by ATO to assess the return manually.

(Paragraph 4.49)

(20) Associated with the introduction of taxpayer self-assessment, the Australian Taxation Office in developing a national compliance and enforcement capability gives priority to the implementation of a fully integrated high quality database able to facilitate efficient taxpayer selection for investigation and tax audit.

(Paragraph 4.50)

(21) The Australian Taxation Office undertake a comprehensive review of the *Income Tax Assessment Act 1936* and where provisions are found to be ambiguous or in need of amendment advise the Government accordingly as to the appropriate actions necessary.

(Paragraph 5.20)



# Chapter 1

## Introduction

### Background

**1.1** This is the 6th review into the Auditor-General's efficiency audit reports carried out by the House of Representatives Standing Committee on Expenditure. In this review, the Committee examined five efficiency audits into the operations of the Australian Taxation Office (ATO), conducted by the Auditor-General over the period January 1982 to December 1984.

**1.2** Specifically, the efficiency audit (EA) reports examined by the Committee were:

- Collection of Sales Tax by the Australian Taxation Office;
- Controls over Processing of Income Tax Assessments;
- Processing and Assessment of Income Tax Returns;
- Checking of Dividends and Interest Disclosed in Income Tax Returns;  
and
- Processing of Income Tax Instalment Declarations.

**1.3** Within the text of this report the titles of the EA reports have been shortened. The Collection of Sales Tax by the Australian Taxation Office EA is referred to as the Sales Tax EA, whilst the four remaining EA reports are referred to, collectively, as the Income Tax EAs.

1.4 The report on sales tax collection is contained in a volume of the 'Reports of the Auditor-General on Efficiency Audits' presented to the Parliament in August 1984. The four income tax audits formed a separate volume of EA reports which was presented to the Parliament in February 1985.

1.5 The objectives of the Committee in carrying out this review were the same as in examination of the earlier EA reports, that is to:

- assess the substantive content of the audit exercise and the quality of the EA report; and
- to examine the response of the audited organisation.

1.6 The Committee's resolve in pursuing this approach was made clear by the Sub-committee Chairman when he said:

I would stress, therefore, that in reviewing any of the Auditor-General's efficiency audits the Committee is as much concerned with the audit process and the performance of the Audit office as it is with the performance of the agency that was audited.<sup>1</sup>

1.7 In addition to examining those specific sales and income tax operations mentioned in the Auditor-General's EA reports the Committee also took up the general question of ATO's effectiveness in combating and reducing the extent of tax evasion and avoidance within Australia. This question encompassed examination of the Prescribed Payments Scheme (PPS) and review of ATO's response to the emergence and rapid growth of tax evasion schemes during the 1970's.

## Conduct of the review

1.8 Under a procedural arrangement which exists between the House of Representatives Standing Committee on Expenditure and the Joint Committee of Public Accounts, it was proposed on 28 February 1985 that the

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<sup>1</sup>Evidence, p. 2



Expenditure Committee would review the EA reports on sales tax collection and income tax assessment practices by the ATO.

**1.9** The Expenditure Committee resolved to undertake the review on 28 February 1985. A Sub-committee was formed on 9 October 1985 to proceed with the matter.

**1.10** Between October 1985 and February 1986 the Sub-committee sought submissions from the Australian Taxation Office, Australian Audit Office, and other interested parties. Included amongst those contacted were professional accountancy organisations, relevant staff trade unions, taxpayer associations and Commonwealth Government Departments.

**1.11** Evidence was taken in public hearings in Canberra on 12, 13, and 18 March 1986 and in subsequent correspondence with witnesses. A list of witnesses and an index of documents authorised for publication are included at Appendices I and II respectively.

**1.12** As is the usual Committee practice, the transcripts of the public hearings and other evidence authorised for publication have been incorporated in a separate volume, copies of which are available on request. References to evidence in the text of this Report relate to page numbers of that volume.

## Chapter 2

# The Efficiency Audit Reports

### Background to Taxation Efficiency Audits

**2.1** Although the Auditor-General has for many years reviewed the financial aspects of ATO operations, these five efficiency audits were the first intensive review by the Auditor-General to examine ATO's principal function, that of taxation assessment and collection. Comprehensive reviews of the ATO by external bodies have been rare in the Office's history and these efficiency audits represent a significant milestone.

**2.2** This series of EAs commenced with the Sales Tax EA in January 1982. Shortly thereafter the audit of Processing of Income Tax Assessments, was conducted at the Hobart Branch of the ATO. Within this second audit the Auditor-General planned to examine certain 'pre-assessment documentation' under the efficiency audit provisions of the *Audit Act 1901*. Access to this documentation was not available under the general audit provisions. In its preliminary stages this audit was interrupted when ATO refused to allow Audit officers access to documentation on withdrawal of assessments before issue. Some 12 months of negotiation ensued. This ended in mid-1983 when the audit recommenced following agreement between the parties on procedures and arrangements by which the efficiency audit powers, particularly those of access, should be used. As a consequence of these arrangements, this audit was carried out under efficiency audit provisions to the extent

that it related to pre-assessment processing but under general audit provisions where it related to post-assessment operations. The three remaining income tax EAs were conducted under a combination of both the efficiency and general audit provisions of the *Audit Act 1901*.

**2.3** Apart from being the first EAs into operational functions of the ATO, these audits are also significant in the coverage they achieved. These EAs, in reviewing several facets of the systems used in sales and income tax assessment and collection have tackled the infrastructure which underlies ATO's major objective. As a result of this, their importance is substantial to the extent that they could contribute to improved assessment and collection of revenue. In terms of revenue, the significance of income and sales tax is undeniable.

**2.4** In his opening remarks to the Committee the Commissioner of Taxation stated that for the 1985-86 year the ATO was budgeted to collect \$46 297 million that is, approximately 79.1% of Commonwealth revenue.<sup>1</sup> Of this budgeted amount, \$386 690 million <sup>2</sup> (83.6%) is expected to be contributed by income and sales tax revenue. (In 1984-85 income and sales tax collections contributed \$34 267 million to Commonwealth revenue.)<sup>3</sup>

## Examination of efficiency audits

**2.5** The purpose of efficiency audits as defined in sub-section 2 (4) of the *Audit Act 1901* is to perform:

- an examination of the functions performed by, and the operations carried on by, the body or person for the purpose of forming an opinion concerning the extent to which those operations are being carried on in an economical and efficient manner; and
- an examination of the procedures that are followed by the body or person for reviewing operations carried on by the body or person, and

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<sup>1</sup>Evidence, p. 4.

<sup>2</sup>1985-86 *Budget Paper No.5, Estimates of Expenditure and Revenue of the Commonwealth Public Account: 1985-86*, AGPS, Canberra, 1985, p. 15.

<sup>3</sup>Ibid.

an evaluation of the adequacy of those procedures to enable the body or person to assess the extent to which those operations are being carried on in an economical and efficient manner.<sup>4</sup>

**2.6** Although definitions of efficiency and economy may vary, the Committee considers the EA reports are a useful starting point in terms of assessing the administrative efficiency of the ATO in performing its functions of sales tax collection and income tax assessment.

**2.7** The general style followed in these EAs was to provide a short description of the process and/or activity involved in the area under consideration and then present Audit's findings and recommendations. As in previous Committee reviews of efficiency audits,<sup>5</sup> it is in the latter area, that the Committee has reservations about the quality of these reports. The findings are usually that the ATO practices leave something to be desired and the recommendations simply suggest that these practices be improved. There are, however, certain areas within the EAs, where the Auditor-General takes a deeper, more creative approach and offers advice or alternatives, but this is more the exception than the rule.

**2.8** The Committee is aware of the view that it is not an auditor's role to become involved in or make recommendations for change to policy. The Committee has no difficulty with this philosophy. However, too often practice and policy become confused and critical evaluation of practice is avoided either because of a fear that any suggestions for change will be regarded as intrusion into policy or because of a fundamental misunderstanding as to what constitutes policy and what constitutes practice.

**2.9** The Committee acknowledges the problems faced in differentiating policy from practice but believes that without provision of comprehensive advice and recommendations on operational shortcomings, the efficiency audit process does not perform to its full potential. Further, the Committee

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<sup>4</sup>*Audit Act 1901.*

<sup>5</sup>Australia, Parliament, *Who Calls Australia Home: Review of The Auditor-General's Efficiency Audit on Control of Prohibited Immigration by the Department of Immigration & Ethnic Affairs*, Parl. Paper 350, Canberra 1985.

considers the Auditor-General, in providing only general recommendations and advice, is neither fully utilising the powers nor discharging the responsibility vested in his office. By taking a more active advisory role, the Auditor-General would not only improve the incisive quality of the efficiency audit process, but could make a tangible contribution to the improvement of public administration. The Committee therefore recommends that:

**Recommendation 1: The Australian Audit Office follow a more positive approach in its reporting by providing, in particular, detailed constructive recommendations and advice to audited agencies in cases where serious deficiencies within an agency's activities are observed.**

2.10 It was noted in each EA that audit findings and recommendations were at times difficult to identify due to the narrative approach applied in these reports. An information technique employed within the Sales Tax EA which seems to overcome this difficulty was the Summary Table of Findings. The table offers at a glance the findings of the audit, suggested audit recommendations and the subsequent effect implementation would have on operations. The Committee believes such a table provides an immediate summation of Audit's work, and considers inclusion of a Summary Table of Findings essential for future audit reports. A viable alternative to such a table, is the consecutive numbering of Audit's recommendations within its audit reports, as recommended by this Committee in one of its earlier reports.<sup>6</sup> The Committee therefore recommends that:

**Recommendation 2: A summary of findings detailing the Australian Audit Office's findings and recommendations be included in all future efficiency audit reports.**

2.11 The Committee was also concerned that the recommendations and suggestions did not set any time targets for implementation. Due to the potential revenue loss associated with any flaw within the taxation assessment or collection process, there was an underlying tone of urgency in these reports for the ATO to act expeditiously in undertaking remedial actions. The EA reports however did not indicate which areas were in the most urgent need of attention.

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<sup>6</sup>Ibid., p. 6.

**2.12** In evidence the Tax Commissioner, Mr Trevor Boucher, expressed his concern when he said:

If there is a reservation it is the notion that the change can be brought about as quickly as it seems to us the Audit Office might be suggesting that it can. There are really enormous demands on this organisation... It is not an overnight task.<sup>7</sup>

**2.13** So that the urgency felt by the Auditor-General, is conveyed to the organisations being audited and some temporal framework is given to make clear the implementation goals seen by Audit, the Committee recommends that:

**Recommendation 3: The Australian Audit Office include time targets for implementation of its efficiency audit recommendations and indicate priorities among these recommendations, such time targets to be set after consultation with departments and authorities subject to efficiency audits.**

## Cost of Efficiency Audits

**2.14** The Auditor-General advised the Committee of the cost of and the hours consumed by each audit. This information is presented in Table 2.1 on the following page.

**2.15** While these audits were in progress the then Auditor-General disbanded the Efficiency Audit Division and set in train the assimilation of efficiency auditing into the general audit divisions of his Office. A period of reorganisation within the Audit Office followed, and as part of this process the original efficiency audit costing method was abandoned. Formulated upon the cost recovery principle, this method had indicated only operating costs of the Efficiency Audit Division and had not taken account of a number of general overhead expenses. The Sales Tax EA was costed on this basis. Commencing with the four Income Tax EAs, this method was replaced by

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<sup>7</sup>Evidence, p. 308.

Table 2.1: Cost of Efficiency Audits

	Hours Taken	\$
Collection of Sales Tax by the ATO	3671	105 922 (a)
Controls over Processing of Income Tax Assessments	219	8 156
Processing and Assessing Income Tax Returns	461	18 519
Checking of Dividends and Interest Disclosed in Income Tax Returns	1067	43 558
Processing of Income Tax Instalment Declarations	928	36 905
Total Audits	6346	213 060

**Note:** (a) Exclusive of general overheads.

**Source:** Submission No. 1, The Australian Audit Office.

the costing method used to calculate all other audits. (Hereafter referred to as the general costing method.) With the application of this method to efficiency audits, the Auditor-General has standardised his charging policy to one costing method, which now applies to all subsequent audits.

**2.16** In evidence to the Committee, the Auditor-General aptly summed up the change in costing system when he said:

Essentially, I suppose, I do not understand the basis for the old costing method which seemed to give an incomplete figure. The method which we now adopt in the efficiency audits is the same as the method which we adopt for those chargeable audits such as financial statements of auditees which attempt to give appropriate representation to the whole of the overhead costs as well as the direct costs. For some reason — I do not think we have anybody in the Office who still remembers why — the early efficiency audits included only the costs of the Efficiency Audit Division.<sup>8</sup>

<sup>8</sup>Evidence, p. 218.

**2.17** Early in its inquiries the Committee became aware of the significant variation in costs between efficiency audits costed under the old costing method (i.e. Sales Tax) compared to EAs calculated under the general costing method. These variations are best illustrated through comparison of average costs. Given that the resources applied to each audit were roughly equivalent, the Committee's examination revealed the average cost of the Sales Tax EA was \$28.85 per hour compared to \$40.05 per hour for the four Income Tax EAs, a variance of 39%. The bulk of this variance, as stated by the Auditor-General in correspondence to the Committee, was due to the inclusion of overhead costs in the general costing method and exclusion of these costs from the previously used costing method. Although inflationary factors account partially for the variance in hourly rates, the major contributory factor remains the difference in the costing method used.

**2.18** When it is understood that efficiency audits can take up to several thousand hours to complete, as is the case with the Sales Tax EA, the significance of an additional \$11.20 per hour to the cost becomes apparent. The Committee endorses the Auditor-General's decision to adopt the general costing method and, in so doing, to account fully for all audit costs. It does, however, note in retrospect that past efficiency audits costed under the previous costing method have been seriously undervalued, in some cases by tens of thousands of dollars.

## **Australian Audit Office Recommendations: Follow-up**

**2.19** The issue of who follows up on Audit's recommendations has been raised on a number of occasions by this Committee. In the past the Audit Office has seen its role as identifying problems and making recommendations, but did not see it extending to any formalised prospective review.

**2.20** The task of follow-up has fallen largely onto committees such as this one and the Joint Committee of Public Accounts. A procedure whereby Ministers write to the Minister for Finance each quarter advising on action that has been taken on recommendations made by the Auditor-General also exists and each department or organisation has to satisfy the Department



of Finance that it has taken steps to rectify shortcomings before the report is allowed to rest. However, until recently these quarterly reports were only required to address those recommendations made in general audits and were not expected to include advice on the implementation of efficiency audit recommendations. While general audits continue to be reported upon, the Department of Finance also now requires comments on efficiency audits to be included within these quarterly reports.

**2.21** It was the Department's understanding that all efficiency audits would be subject to review by a parliamentary committee and therefore did not require Departmental follow-up. The recent change to this procedure was largely brought about by the increasing frequency of efficiency audit reports. The Committee supports the Department of Finance's decision to require quarterly reports on efficiency audits and feels this action will improve the effectiveness of the audit process.

**2.22** The Auditor-General also undertook to obtain copies of these quarterly reports with a view to reviewing, for planning purposes, the progress made by organisations in rectifying the shortcomings identified by efficiency audits. As stated in evidence by the Auditor-General:

What we should do, in effect, and what I think we should do, as this conversation has developed, is receive these reports. We maintain what we call an auditee portfolio but which really is our intelligence base about the auditees, and it helps us to decide what we will do with them next and what we might do later. This would be valuable information to feed into that base ...<sup>9</sup>

**2.23** As part of this exercise, the Committee considers the Auditor-General should take a more active role in the prospective review function. This could be achieved by advising the Parliament of any instances where the organisation's reported remedial actions were considered to fall short of that required. The Department of Finance could then follow-up the Auditor-General's comments with respective audited organisations and keep the relevant parliamentary committees informed of developments. In this connection, it would be useful if the recommendations of Audit were made rather

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<sup>9</sup>Evidence, p. 226.

more specific than they tend to be at present (see Recommendation 2). Thus, the Committee recommends that:

**Recommendation 4:** The Australian Audit Office be given, on a timely basis, a copy of all quarterly reports sent to the Minister for Finance concerning implementation of recommendations in efficiency audit reports.

**Recommendation 5:** The Australian Audit Office advise the Parliament at the first available opportunity of deficiencies in the implementation of efficiency audit recommendations.

**Recommendation 6:** The Department of Finance actively follow-up the comments made by the Auditor-General and keep the Parliament informed by reporting regularly to the parliamentary committees that examine efficiency audit reports.

## **Australian Audit Office's Overall Performance**

**2.24** As stated earlier, the five efficiency audits under review by the Committee were undertaken over a three year period from January 1982 to December 1984. The length of time taken to conduct the major field work component of these audits varied from ten months for the Sales Tax EA to seven months for the Processing and Assessment of Income Tax Returns EA. When report preparation, assessment of ATO comments and transmission of the report to Parliament are considered, the duration of these audits ranged again from approximately two and a half years for the Sales Tax EA to approximately 10 months for the Processing and Assessment of Income Tax Returns EA. The major difference in elapsed time between the two audits appears to have been the 8 months of negotiation and correspondence with the ATO required in order to clarify relatively minor issues. Of these, the calculation of additional tax for late payment of sales tax was significant. However, resolution of these matters would appear to have been overly protracted.

**2.25** Although it may have been possible to table the report on collection of sales tax at an earlier date, the Committee nevertheless acknowledges that, overall, this series of efficiency audits has been conducted within reasonable time frames and represents a significant improvement in the performance of efficiency audits compared with earlier EAs.

**2.26** The ATO appeared somewhat reserved as to the conduct of these EAs and their parameters, but was generally in agreement with the principal notions being put forward by Audit's recommendations. In fact, it was stated by the Commissioner of Taxation that Audit's inquiries appeared to closely align with those being carried out by his Office:

The reports point to a number of things; we would say that they are things that we knew about. Much of the source material that is used by the Auditor-General in his report was provided by us because we had been looking into these things ourselves.<sup>10</sup>

**2.27** As for ATO's reservation concerning audit parameters, this became clear in the Commissioner of Taxation's evidence to the Committee:

Naturally, we have no difficulty in being subject to Audit Office scrutiny, but we would think there is something wrong with the concept of efficiency audits if we were to be taken to task about particular aspects, particular segments, of our activity if adequate attention is not also given to the whole area over which we must spread limited resources, that bottomless pool of work.<sup>11</sup>

**2.28** While the Commissioner of Taxation may be suggesting that an overall management review of ATO is preferable to specific efficiency audits, the Committee would suggest that the two approaches should be seen to be complementary rather than alternatives. Hence, Mr Boucher's argument does not diminish the critical importance of the efficiency audit process as a valuable review mechanism.

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<sup>10</sup>Evidence, pp. 4-5.

<sup>11</sup>Evidence, p. 5.

**2.29** The Committee feels that no matter what area the Audit Office had chosen to review, problems would have been found. This situation appears to arise from ATO's inadequate priority setting mechanisms and therefore the Committee recommends:

**Recommendation 7: The Government establish a Joint Management Review to investigate the overall performance and operation of the Australian Taxation Office and inform the Parliament of the outcome of the review.**

**Recommendation 8: Commencing immediately, the Australian Taxation Office develop adequate priority-setting mechanisms detailing areas that they consider require examination and that this mechanism and identified areas be outlined in ATO's annual report indicating the progress achieved at subsequent intervals.**

**2.30** The Committee considers that these five efficiency audits represent a marked improvement in the quality and substance of efficiency audits over earlier attempts. Although further refinements are necessary, the Committee is generally satisfied with the progress being made by the Auditor-General in the efficiency audit process as reflected in the audits reviewed by this Committee.

## Chapter 3

# Problems Within The ATO

**3.1** By reviewing concurrently the five efficiency audits, the Committee in its initial inquiries became aware of a number of serious shortcomings *within certain ATO philosophies and operations*. These shortcomings indicated inefficiencies within ATO's taxation assessment and collection operations, and suggested that significant losses to taxation revenue were being incurred. Unnecessary costs have also been imposed upon the taxpayer. It appears that taxpayers needlessly provide information to the ATO, some of which cannot possibly be used. It is apparent the ATO collects this information in the naive belief that by doing so will ensure compliance by taxpayers. The Committee examined these and further matters during public hearings, vigorously questioning the ATO and other witnesses as to the background of and possible remedies to these problems. As the questioning progressed it became apparent that a number of overriding fundamental problems exist within the ATO and, as a result of these, operational deficiencies had developed.

**3.2** The Committee remains concerned that substantial taxation revenue losses have and will continue to be sustained whilst these deficiencies go untreated.

### Underdevelopment of computerisation

**3.3** Of all the deficiencies noted, the lack of computerisation within ATO's taxation assessment and collection process is the most puzzling. In view

of advances in computerisation over recent years, it is difficult to imagine that the ATO continues to perform manually many of the repetitive and mundane checking tasks associated with the taxation assessment process. This, however, is the case. Contrary to popular belief, every income tax return currently lodged with the ATO is manually checked and assessed by one of approximately 2500 assessing officers.<sup>1</sup>

**3.4** In his report on the Processing and Assessment of Income Tax Returns EA, the Auditor-General suggested that improvements to the assessing process could be achieved through further computerisation:

Audit concludes that the efficiency of the assessing function as presently practised in the ATO would benefit from further computerisation of the process and that staff could thereby be released to be more effectively employed in compliance activities. Computerised assessing offers to the ATO the prospect of using more productively and in more professionally satisfying work a large number of the experienced and technically trained staff presently engaged wholly in assessing.<sup>2</sup>

**3.5** Although not specifically the route suggested by the Auditor-General, the introduction on 1 July 1986 of taxpayer self-assessment will progressively over the two year phasing-in period free up a number of assessing staff for compliance examination activities. In evidence, the Taxation Commissioner said:

In the area of self-assessment, we have estimated that over a two-year period we would hope to release something of the order of 1200 staff from technical assessing duties on to field or in-house auditing activities.<sup>3</sup>

The Committee recommends that:

**Recommendation 9: The Australian Taxation Office, as part of the proposed priority-setting mechanism outlined in Recommendation 8, detail in its annual reports**

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<sup>1</sup>Evidence, p. 19.

<sup>2</sup>Australia, Parliament, *Reports of the Auditor-General on Efficiency Audits: Processing and Assessment of Income Tax Returns*, Parl. Paper 159, Canberra, 1984, p. 20.

<sup>3</sup>Evidence p. 11.

the progress of staff numbers transferred from technical assessing duties to compliance areas such as field or in-house auditing activities.

**3.7** However, the lack of computerisation within ATO's operations remains a problem. Apart from noting an apparent lack of electronic processing in mainstream assessing activities the Auditor-General also indicated problems in peripheral checking exercises. This was clearly outlined by the Auditor-General in his EA report, 'Checking of Dividends and Interest Disclosed in Income Tax Returns where he stated:

The ATO had failed to take full advantage of technological advances that should permit computerised processing...<sup>4</sup>

**3.8** Although the Auditor-General was specifically commenting on interest data obtained from financial institutions, the evidence taken by the Committee strongly suggests this failure was widespread and certainly applicable to all taxation assessment and collection operations.

**3.9** Information provided to the Committee suggests this failure has severely hindered ATO's capacity to process all external data vital for checking activities and pointed to inordinate levels of human resources being involved in repetitive and mundane tasks. Simply put, the ATO could not process all data it received. This is a major problem in view of the fact that ATO is reliant on its information matching system in order to assess the full liability of taxpayers to taxation. Failure to process data represents a serious breakdown in ATO's assessing ability. Evidence collected by the Committee suggested that in terms of lost taxation revenue and staff morale ATO's failure to recognise and take advantage of technological advances was catastrophic. The Committee saw deficiencies as inherent within the current information collection system. The ineffectiveness of current taxation operations led the Committee to believe serious consideration should be given to alternative tax collection systems and in particular to an expansion of the range of withholding taxes. These issues will be considered in some detail in the latter stages of this report.

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<sup>4</sup> *Reports of the Auditor-General on Efficiency Audits*, p. ii.

**3.10** The current status of ATO's electronic processing, was aptly summarised by Mr S. Prtyz of the Administrative and Clerical Officers' Association (ACOA) in evidence to the Committee:

Their database is woefully inadequate. Their computer system, their ability to extract the required data and to be able to interface that data between different systems, is inadequate. They do a lot of manual checking now where, theoretically, they should be able to run two different computer tapes, interface them and get a computer printout. There is that sort of thing that goes on.<sup>5</sup>

**3.11** The core of this problem seems to stem from ATO's apparent inability to purchase computers and associated equipment. As shown by Table 3.1, ATO has over a 10 year period underspent by at least \$49.0m its appropriations for computer plant and equipment.

**3.12** In light of these figures it is interesting to reflect on comments made to the Committee by senior officers of the ATO:

Our equipment is old and our systems are old.<sup>6</sup>

I would like to reiterate that at the present time the Tax Office is operating in a computing environment which was planned for in the early 1970s and one which was introduced in the mid-1970s.<sup>7</sup>

**3.13** Despite having had over the last 10 years an additional \$49.4m available for computer equipment, the ATO admits that there are serious inadequacies within its automatic data processing (ADP) operations. For example, from ATO's 1983-84 Annual Report:

There are serious inadequacies in our computer systems, due mainly to their age.<sup>8</sup>

And, from the 1984-85 Annual Report:

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<sup>5</sup>Evidence p. 82.

<sup>6</sup>Evidence, p. 8.

<sup>7</sup>Evidence, p. 15.

<sup>8</sup>Australian Taxation Office, *Annual Report 1983-84*, AGPS, Canberra, 1984, p. 14.



Table 3.1: Australian Taxation Office Computing Plant and Equipment Expenditures

Year	Appropriation \$	Expenditure \$	Underspent \$
1976-77	2 095 000	1 926 675	168 325
1977-78	1 264 000	622 616	641 384
1978-79	1 111 000	233 832	877 168
1979-80	2 187 000	466 410	1 720 590
1980-81	1 652 000	864 517	787 483
1981-82	3 291 000	1 319 099	1 971 901
1982-83	14 768 000	10 464 561	4 303 439
1983-84	28 069 000	9 737 319	18 331 681
1984-85	21 405 000	10 944 420	10 460 580
1985-86	12 941 000	2 808 251(a)	10 132 749
	88 783 000	39 387 700	49 395 300

Percentage (%) Expenditure to Appropriation 44.4%

**Note:** (a) Expenditure as at 15 May 1986 per Department of Finance Ledgers

**Note:** Recent advice from the Department of Finance indicates that during the period 15 May to 30 June 1986, ATO expended a further \$10,130,066 bringing total 1985-86 expenditure to \$12,938,317.

**Source:** Details compiled by Department of Finance from Appropriation Bills No. 2 from 1977-78 to 1985-86.

ADP facilities for the Prescribed Payments System are still insufficient.<sup>9</sup>

**3.14** As explanations of its underspending, ATO advanced to the Committee delays in supply of equipment together with a universal shortage of specialised ADP staff.<sup>10</sup> There was also evidence that ATO had also suffered from poor management and direction of its ADP area.<sup>11</sup> This in part, seems to be supported by the findings of ADP consultants commissioned to review ATO's Technical Strategy Plan.<sup>12</sup> Their subsequent report made 40 recommendations and effectively dismissed ATO's strategy. As reported in ATO's 1984-85 Annual Report:

<sup>9</sup>Australian Taxation Office, *Annual Report 1984-85*, AGPS, Canberra, 1985, p. 40.

<sup>10</sup>Evidence pp. 13 and 255.

<sup>11</sup>Evidence, p. 68.

<sup>12</sup>Computer Sciences of Australia, *The Report on Technical Strategy Plan for Australian Taxation Office*, 1984, unpublished report to ATO, pp. 1-2, to 1-9

The last report referred to inadequacies in the Office's computer systems. A strategy to remedy the deficiencies has been developed and this strategy was being reviewed by independent consultants at the time of the last report.

The consultant's report was received at the end of 1984. It indicated that the strategy should be revised. Essentially the consultants said that the strategic plan required strengthening in terms of the goals it set down, its relevance to user requirements, its recognition of alternatives and the specification of priorities.<sup>13</sup>

**3.15** The combination of these factors suggest that within ATO the potential of computerisation was not fully appreciated or that, even if it was, poor internal guidance effectively nullified any substantial implementation of new technologies. ATO's processing capacity, as a result, has been totally inadequate compared to its needs.

**3.16** ATO's past record in implementing new technologies has been deplorable. Due to its apparent inability to utilise all the funding available to it, the ATO currently lacks the necessary processing capacity to effectively collate and process all information available to it. The ability to process all available data is particularly critical to ATO's income detection activities. Without access to external data the ATO is unable to determine whether all income received by a taxpayer is actually disclosed in their annual income tax return.

**3.17** Evidence to the Committee would suggest non-detection of income by the ATO has led to significant taxation revenue losses. Although total revenue losses are not known, it was estimated by the Auditor-General, in the interest and dividend area alone, between \$308m and \$512m is lost in taxation revenue each year by taxpayer non-disclosure of income and subsequent non-detection by ATO.<sup>14</sup> Given that these figures represent only one source of income, taxation revenue losses through non-detection of total taxpayer incomes could conceivably amount to several billion dollars each year.

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<sup>13</sup>ATO, *Annual Report 1984-85*, p. 39.

<sup>14</sup>*Reports of the Auditor-General on Efficiency Audits*, p. 30.

**3.18** This situation arises not simply because of highly organised evasion schemes. In large measure, it can simply be attributed to ATO's own internal inadequacies. The form in which information is provided to the ATO has certainly contributed to these inadequacies. For example, under Income Tax Regulation 11(2) all companies are required to supply ATO with details of all persons to whom interest in excess of \$100 is paid. However, this regulation does not stipulate the medium on which information is to be supplied and consequently the format of information received varies from hard-copy computer printouts to magnetic tapes. Apart from compatible magnetic tapes (that is, tapes in a format easily processed by ATO) supply of information in other forms significantly reduces the efficiency of ATO's matching processes. The Committee believes existing legislation should be strengthened to require organisations to supply information in a compatible form and on a medium as prescribed (from time to time) by the ATO. Such an amendment should take account of further technological advances. Notwithstanding these comments, ATO's failure to effectively implement computerisation has severely reduced its capacity, with this failure seen as being symptomatic of a more fundamental problem.

**3.19** Recently ATO has set about developing new ADP strategies. This involved in 1985 a complete re-appraisal of all aspects of automatic data processing within ATO. The culmination of its efforts was the release in November 1985 of a new triennial ADP Strategic Plan. The plan has since been revised in February 1986.

**3.20** In short, the Strategic Plan proposes a move to a more interlinked standardised processing system. To enable this, purchases of ADP and related communication equipment in the order of \$210m are envisaged. These purchases have already commenced. As mentioned in Table 3.1 the ATO spent \$10.1m in the last six weeks of the 1985-86 financial year on ADP and related equipment. These are in accordance with their strategic plan. Whether these purchases were in reaction to the Committee's inquiries or whether they were planned is unknown. Although somewhat belated, ATO's current ADP policy appears to be a positive step in further computerising its operations. With regard to ATO's Computerised processing, the Committee recommends that:

**Recommendation 10: In implementing its 1985 ADP Strategic Plan the Australian Taxation Office (ATO):**

- (a) give priority to improving its income detection capability; and
- (b) examine the need for information supplied to it under Income Tax Regulation 11(2) to be compatible with systems in ATO and advise the Government accordingly.

## **Staff Resources**

**3.21** Over the past 10 years ATO's operations have become increasingly labour-intensive. Through its inability to successfully integrate Computerised processing, ATO has continually relied upon manual processing as the backbone of its operations.

**3.22** With the expansion of ATO's responsibilities together with increasing workloads in traditional taxation areas, the Office in meeting these extra demands relied on increasing its staff resources. From June 1975 to June 1984, ATO's full-time staffing levels rose from 12 401 to 15 595 representing a staff increase of 25% over that period.<sup>15</sup> The growth within the Australian Public Service over this corresponding period was approximately 6.8%.<sup>16</sup>

**3.23** In evidence, the Commissioner of Taxation informed the Committee that a significant proportion of these additional staff resources were allocated to new functions within the ATO. Apart from the Prescribed Payments System, such areas as bottom of the harbour tax recoupment and freedom of information were mentioned.<sup>17</sup> Putting aside these staff allocations, the Commissioner of Taxation stated that staffing increases within traditional functions had been considerably less than the staff required as suggested by ATO's workload indicator growth figures.<sup>18</sup> As a result, despite ATO's current staffing levels of 16 500 the Commissioner believes his organisation to be understaffed.

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<sup>15</sup>Submission No. 2.

<sup>16</sup>Ibid.

<sup>17</sup>Evidence, p. 21.

<sup>18</sup>Evidence, p. 20.

**3.24** Although the ATO may well suffer from staff shortages, the Committee considers along with the Auditor-General that additional staff resources may not be the solution to ATO's problems. As pointed out by the Auditor-General in the Foreword to the Income Tax EA's:

a major contribution to resolving many of the problems faced by the [Taxation] office might be made not by the provision of further staff but by the more productive and effective use of those already engaged. It appears that such an outcome could be achieved.<sup>19</sup>

**3.25** This notion was supported by a number of witnesses appearing before the Committee. From the evidence taken, several causal factors were highlighted. The lack of computerisation within ATO's operations resulting in excessive levels of manual processing has already been mentioned. More importantly, the prime cause of ATO's inability to maximise the amount of revenue collected with its current level of resources has been the absence of forward planning and the establishment of priorities. Planning has been virtually non-existent in respect of human resources and ADP facilities. This inactivity stems from ATO's all-consuming pre-occupation in past years with tax evasion and avoidance schemes.

**3.26** The effect tax evasion had on ATO's outlook and operations should not be underestimated. As the Commissioner of Taxation, somewhat emotionally, pointed out:

as it [the Committee] looks at our performance in these areas it should take account of the impact of tax schemes in the late 1970s, the early 1980s and their aftermath, because it is still with us. The tax system in that time had a knife at its jugular. Coping with that was, and has been a pre-occupation of key people in the Office.<sup>20</sup>

**3.27** ATO's pre-occupation with tax schemes was not without cost, as this period marked the beginning of a significant decline in the efficiency

<sup>19</sup> *Reports of the Auditor-General on Efficiency Audits*, p. iii

<sup>20</sup> Evidence, p. 6.

of ATO's day to day operations. Most of ATO's assessment and collection systems were running smoothly in the 1970s, affording ATO the 'luxury' of resources to concentrate on tax evasion. The prevailing philosophy within the ATO at this time seemed to be that as long as traditional collection systems were ticking over and taxation revenues were coming in, no close attention or advanced planning for these systems was required.

**3.28** However, as work volumes increased and traditional systems became stretched, ATO responded by demanding extra staff to bolster the already swelling ranks involved in manual processing operations. This was the short-term and short-sighted solution. In hindsight, ATO would have been better served by further computerising the routine tasks associated with traditional collection systems. As it now appears, the approach taken was akin to fine tuning systems that were in desperate need of major overhaul.

**3.29** Due to its reluctance to change from tried and true work practices, ATO now finds itself encumbered with a highly labour intensive taxation infrastructure, quickly approaching its operational limits. This predicament is due at least in part to ATO's past inactivity and lack of foresight.

**3.30** Further computerisation of ATO's operations is essential. The first sign of redressing this problem was seen with the release of ATO's ADP Strategic Plan. Implementation of this plan is expected to release upwards of 300 staff from routine tasks.<sup>21</sup> Coupled with this, an additional 1200 staff are expected to be released from routine duties on the introduction of taxpayer self-assessment. All staff will be re-deployed into more cost effective areas.

**3.31** ATO now finds itself in a position where significant modifications to its infrastructure are needed. Although ATO has confessed to knowing of these deficiencies years ago, remedial actions have only begun in the last few months. ATO's past performance can only count against it as it strives to gain support and funding for future improvements.

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<sup>21</sup>Evidence, p. 10.

**3.32** At this juncture, it should be pointed out that the Joint Committee of Public Accounts (JCPA) has a standing reference to review proposed major ADP acquisitions (generally over \$5m) by departments and agencies staffed under the *Public Service Act 1922*. The Committee understands that the JCPA will shortly be receiving a reference on ATO's proposed ADP acquisitions.

**3.33** While the Committee has touched upon ATO's future ADP directions it is felt through this review mechanism, the JCPA will be better placed to offer detailed comment on ATO's proposed ADP acquisitions and future applications. To the extent ATO's ADP operations have been examined in this report, the Committee recommends that:

**Recommendation 11: The Australian Taxation Office establish a regular review and reporting mechanism in regard to its actual and proposed ADP operations; this mechanism to be along the lines suggested in Recommendation 8.**

## Existing taxation legislation

**3.34** Apart from contending with its internal problems, the ATO has had to cope with the task of administering the increasing complexities of the taxation legislation. As pointed out by the Commissioner of Taxation the escalating complexity of taxation legislation is a burden to the ATO.<sup>22</sup>

**3.35** ATO's concern arises from the highly interpretative nature of certain sections within taxation law. The responsibility for assessing and ruling on taxpayers' interpretations has fallen to the ATO and provides a continual stream of work.

**3.36** From evidence taken by the Committee it would appear that although the taxation law is literally quite specific the problem lies in its interpretation in certain real world commercial situations. The Committee does not consider that any broad statement is necessary on this matter, but will refer

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<sup>22</sup>Evidence, p. 42.

to particular paragraphs of the *Income Tax Assessment Act 1936* in Chapter 4 of this report.

## Effect on ATO's operations

**3.37** The major problem confronting the ATO is its lack of processing capacity. Currently it cannot utilise all the external data available to it nor can it perform the number of checks and investigations necessary to ensure all tax due and payable is actually collected. The taxation system relies heavily on the honesty of taxpayers and the surrounding mystique of ATO's operations. Community compliance with taxation laws is largely dependent upon the perceived operations of the ATO rather than on its actual operations.<sup>23</sup>

**3.38** At the heart of this problem, lies the intertwining relationship between the lack of computerised data processing and ATO's continued dependence on labour-intensive work practices. Its current operations are ineffective and reflect ATO's past poor management. The complexity of taxation legislation does not help the ATO in its endeavours to improve its efficiency and effectiveness.

**3.39** This problem has not manifested itself overnight. Although ATO has begun to redress many of its problems, their effect on current operations is still being felt. Chapter 4 goes on to illustrate specific examples of ATO's deficiencies and areas where probable revenue losses have occurred.

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<sup>23</sup>Evidence, p. 117.



## Chapter 4

# Specific Deficiencies

**4.1** As this inquiry progressed the Committee became increasingly concerned that a number of apparent difficulties existed within ATO's revenue assessment and collection operations. Raised initially by the Auditor-General's findings, this concern was heightened as further evidence not only confirmed the existence of serious deficiencies within ATO's operations, but suggested these could lead to significant non-realisation of taxation revenues.

**4.2** It now appears to the Committee, that many of these deficiencies were a by-product of ATO's failure to implement advanced technologies and revise work practices. Others resulted from external factors. However, all appear to various degrees to affect ATO's revenue collection abilities. The deficiencies within ATO's operations noted during the Committee's investigations are detailed within this chapter.

### Dividends and interest

**4.3** In order to assess the full tax liability of each taxpayer, the ATO operates an information reporting and matching system. The system entails large scale collection of financial information and subsequent cross-checking of this to details contained within taxpayers' returns. Inherent to its success is the quantity and quality of information received and the quality of the matching process. With respect to dividends and interest ATO's system has not been effective in detecting undisclosed income.

4.4 Based upon the Australian Bureau of Statistics (ABS) 1983-84 National Accounts figures, the Australian Audit Office estimated that the amount of tax revenue foregone because of undisclosed dividend and interest income is in the range of \$308m to \$512m per annum.<sup>1</sup> These figures are not disputed by the ATO. It must be pointed out that the ATO considers non-disclosure of interest income to be the major problem as it is by far the larger component. Non-disclosure of dividends is seen as being negligible because tax rebates are available on most dividends.<sup>2</sup>

4.5 This non-realisation of taxation revenues has arisen because of two fundamental problems within the information reporting system: lack of information, and inadequate matching capabilities. Evidence to the Joint Committee on an Australia Card revealed that information provided to the ATO is extremely limited. For example, only 18-20% of all interest paid is reported, of that which is provided very little is checked, and of that checked, only about 50% is successfully matched — more would require tedious manual checking with low cost-benefits.<sup>3</sup>

4.6 The current limited supply of information may have in part originated in the 1970s, when as the Auditor-General suggests ATO did not take a firm and consistent approach in gaining customer interest statements from financial institutions, in particular trading and savings banks.<sup>4</sup> Further, the Auditor-General felt that if ATO had adopted a more active approach

...in the mid-seventies to encourage the savings banks to make the necessary changes for providing interest information when they next upgraded their computerised systems, interest information should have been more readily available.<sup>5</sup>

4.7 ATO's past stance may well have been influenced by the fact, that even if such data had been received, ATO lacked the necessary capacity to

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<sup>1</sup> *Reports of the Auditor-General on Efficiency Audits*, p. 30.

<sup>2</sup> Australia, Parliament, *Report of the Joint Select Committee on an Australia Card*, (Australia Card Report), Parl. Paper 175, Canberra, 1986, p. 139.

<sup>3</sup> *Ibid.*, p. 131.

<sup>4</sup> *Reports of the Auditor-General on Efficiency Audits*, p. 33.

<sup>5</sup> *Ibid.*

process it. As stated by the Commissioner of Taxation in evidence to the Committee:

Having got information in, it is then a question of having the resources to process it. Looking back over those years, we have not had sufficient resources to check more information than the information we have got in.<sup>6</sup>

Similar comments were also expressed by the Australian Bankers' Association.<sup>7</sup>

4.8 Apart from the difficulty in gaining information, the ATO faced problems within its matching capability. As mentioned earlier, only about 50% of information received is matched.<sup>8</sup> This low matching rate can be attributed in part to ATO's inability to develop an effective matching system.

4.9 Within his EA report 'Checking of Dividends and Interest Disclosed in Income Tax Returns' the Auditor-General expressed concern that ATO had not taken full advantage of technological advances in respect of matching dividends and interest income. Further evidence given by officers of the Australian Audit Office also suggests ATO's current approach to dividends and interest checking is inappropriate and virtually ineffective. Mr Antony Minchin, Acting Assistant Auditor-General told the Committee:

...from what we have seen of the dividends and interest check in the Taxation Office, it seemed to us they would never get it right;

...It did seem to us in the dividends and interest check audit that the ADP area was not well organised. Had it had more resources, it might have made a bigger mess.<sup>9</sup>

4.10 It appears that ATO has continued with the dividends and interest check in much the same form as was criticised by the Auditor-General, except that even further staff resources have been allocated to the check. It was shown that the dividends and interest check in 1983-84 raised an

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<sup>6</sup>Evidence, p. 261.

<sup>7</sup>Submission No. 8

<sup>8</sup>Evidence, p. 244.

<sup>9</sup>Evidence, pp. 191 and 230.

extra \$14.2m in tax assessed, while in 1984-85 (with an additional 115 staff specifically for checking activities) the increase was \$18.7m<sup>10</sup> However, this figure represents only 6% of the lowest estimate of tax revenue foregone. A further deployment of 115 staff in 1985-86 is expected to produce similar results.<sup>11</sup>

**4.11** The ATO acknowledges the problem it faces cannot be solved by adding hundreds or even thousands of additional staff and realises the solution lies in the re-assessment and computerisation of underlying procedures and systems.<sup>12</sup> The Committee is however astounded that the ATO has persevered so long with this labour intensive approach when funding for ADP acquisitions has been so significantly underspent over recent years. (See Table 3.1)

**4.12** The inadequacy of ATO's current approach is distressing. The ABS estimates that for 1984-85 approximately \$13 871m was paid in interest to Australian households.<sup>13</sup> Using the figures quoted to the Australia Card Committee by ATO, only \$2774m of this is reported. Of this reported information only \$1387m is actually matched to taxpayers' returns.

**4.13** Further, the ATO has the additional burden of an anomaly existing within current taxation legislation. Under Income Tax Regulation 11 (2) all companies are required annually to supply ATO, with details of all persons to whom interest in excess of \$100 is paid. However, this applies only to companies, and notably excludes the Reserve Bank of Australia from providing interest details.

**4.14** This is an obvious loophole within ATO's collection powers, and has the potential to become a major area for tax evasion within Australia. The Committee's major concern lies with Commonwealth Bearer Bonds where interest paid in recent years has grown dramatically from \$6.6m in 1980-81

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<sup>10</sup>Evidence, p. 252.

<sup>11</sup>Evidence, p. 253.

<sup>12</sup>Ibid.

<sup>13</sup>Information supplied by Australian Bureau of Statistics in correspondence to the committee, dated 9 July 1986.

to \$35.6m in 1984-85.<sup>14</sup> Evidence suggests that bond holders can insist that interest be paid in cash.<sup>15</sup> It was also apparent that ATO was not aware of this five fold increase in interest paid.<sup>16</sup>

4.15 Although the issue of bearer bonds was terminated on 2 July 1984 all holders of Inscribed Stock issued prior to that date are entitled to exchange their stock for bearer bonds. Until recently this was not known by the ATO.<sup>17</sup> Subsequent inquiries by the ATO have determined that as at April 1986 the face value of bonds on issue eligible for conversion to bearer form was approximately \$29 500 m. Of this amount approximately \$300 m have already been converted to bearer form.<sup>18</sup> Although the ATO considers 'many of these bonds would be held by large institutions who would see no advantage in conversion to bearer form', it concedes nevertheless that 'there is obvious scope for large scale evasion'.<sup>19</sup>

4.16 The Committee on the evidence before it, does not believe that continuation of the information reporting and matching system, however improved, is the most effective option available to ATO. An alternative initially raised in the Auditor-General's EA report and strongly supported by various witnesses was the introduction of a withholding tax on interest and dividends paid or credited to Australian residents. A withholding tax deducted by paying institutions already applies in respect of dividends and interest payable to overseas residents.

4.17 In evidence the Commissioner of Taxation agreed that a withholding tax could be more effective than traditional collection techniques, when he said, '... an appropriate system of deduction at source could raise more revenue than an information reporting system'.<sup>20</sup> Also, as estimated by Treasury, 'a withholding tax could bring in about two-thirds of the amount of

<sup>14</sup>Figures contained in Reserve Bank of Australia correspondence to the Australian Audit Office, 23 July 1985.

<sup>15</sup>Evidence, p. 199.

<sup>16</sup>Evidence, p. 267.

<sup>17</sup>Australian Taxation Office (ATO) correspondence to the committee, 9 April 1986.

<sup>18</sup>Ibid.

<sup>19</sup>Ibid.

<sup>20</sup>Evidence, p. 236.

tax evaded on undisclosed interest'.<sup>21</sup>

4.18 As indicated to the Committee by the Australian Audit Office, a withholding tax regime would certainly be more cost-effective, that is to say, the cost of collecting a dollar of revenue using a withholding tax would be significantly less, possibly 10 times less, than the cost of collecting a dollar of revenue using the current information reporting system.<sup>22</sup>

4.19 Many forms of withholding tax currently exist within Australia, the more commonly known being PAYE and the Prescribed Payment System. With the introduction in 1987-88 of imputation of company dividends, (another form of withholding tax), evasion through non-disclosure of dividends should no longer be a problem. On the grounds of efficiency and effectiveness the introduction of a withholding tax on interest would appear the next logical step. Accordingly, the Committee recommends that:

**Recommendation 12: As a matter of urgency, the Australian Taxation Office advise the Government on the effectiveness and cost-effectiveness of a withholding tax on interest paid to Australian residents by all companies and financial institutions, including the Reserve Bank of Australia.**

4.20 In view of these disclosures the Committee believes that the focus of the taxation collection system should be changed and that a generalised withholding tax system be introduced. Although introduction of this, by itself, would not improve the inadequate collection methods of the ATO, it would change the emphasis to collection of money which can subsequently be recouped by the taxpayer if necessary, and away from collection of information which must be processed and followed up by the ATO prior to collection of taxation revenue. The Committee therefore recommends that:

**Recommendation 13: The Australian Taxation Office undertake a study of the effectiveness and cost-effectiveness of alternative tax collection systems (with particular**

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<sup>21</sup>Evidence, p. 193

<sup>22</sup>Ibid.

emphasis on a generalised withholding tax structure) and advise the Government accordingly.

## Prescribed Payments System

**4.21** The Prescribed Payments System (PPS) was introduced in September 1983, amidst concern that in particular industries, unincorporated businesses were disclosing in returns as little as 60 per cent of income received.<sup>23</sup> This system provides for tax to be deducted at source from certain payments for work in the motor vehicle, cleaning, building and related industries. Currently, PPS is deducted by the payer at a rate of 30% or, if the payee is registered with the ATO and quotes a tax file number at the time of receiving the payment, at a rate of 15%.<sup>24</sup>

**4.22** In its first two years of operation the PPS generated tax revenues of \$250m and \$300m respectively.<sup>25</sup> For the 1985-86 year, ATO estimates revenue at \$500m with current collections running ahead somewhat, of this figure.<sup>26</sup>

**4.23** Although PPS has made an impact within those industries targeted, the ATO is unaware whether any substantial increase in the disclosure of unincorporated incomes has occurred. One ATO officer speculated that disclosure of unincorporated business incomes may rise by 10% to 20% as a result of PPS but further questioning by the Committee revealed that no 'hard facts' were available.<sup>27</sup> In fact, it appears ATO has not studied this question.<sup>28</sup>

**4.24** As reported by the Auditor-General in March 1986, the original problem remains:

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<sup>23</sup> *Reports of the Auditor General on Efficiency Audit*, p. 15.

<sup>24</sup> Evidence, pp. 32-33.

<sup>25</sup> Evidence, pp. 35 and 274.

<sup>26</sup> Evidence, p. 32.

<sup>27</sup> Evidence, pp. 33-34.

<sup>28</sup> *Ibid.*

In respect of unincorporated businesses, the ATO has estimated that only 63% to 75% of reportable farm income and 70% to 75% of reportable non-farm income is disclosed in returns . . . Tax evaded by understatement of income and overstatement of expenses by unincorporated businesses was estimated to amount to \$1,000 million per annum.

Companies were considered to disclose a higher proportion of income than unincorporated businesses. Tax evaded by understatement of income and overstatement of expenses by companies was estimated to amount to \$500 million per annum.<sup>29</sup>

**4.25** In September 1985 the Treasurer announced as part of the Government's taxation reforms increases in PPS deduction rates to 15% and 30% respectively, effective 1 July 1986. These changes are expected to raise an additional net revenue of \$105m in 1986-87 and \$45m in subsequent years.<sup>30</sup> Also, the Government announced that it will further review the operation of the PPS, including the industry coverage.<sup>31</sup>

**4.26** Given the massive extent of non-disclosure of unincorporated business and to a lesser degree company incomes the Committee wholeheartedly supports these Government initiatives. The need to expand PPS was particularly visible from the evidence presented to the Committee. Consequently, the Committee recommends:

**Recommendation 14: The review of the Prescribed Payments System (PPS) announced by the Treasurer in his September 1985 statement be expedited and the report be presented to the Parliament soon after the completion of the review.**

**4.27** Apart from the obvious revenue aspects of PPS, the system has also proved successful in detecting persons who although required to do so, had not previously lodged tax returns. Referred to as non-lodgers, the ATO

<sup>29</sup> Australia, Parliament, *Report of the Auditor-General upon audits, examinations and inspections under the Audit and other Acts*, Parl. Paper 30, Canberra, 1986, p. 143.

<sup>30</sup> *Statement by the Treasurer, The Hon. Paul Keating, MP: Reform of the Australian Taxation System*, AGPS, Canberra, 1985, pp. 55-56.

<sup>31</sup> *Ibid.*



through PPS checking has detected 22 297 non-lodgers and subsequently issued 20 335 assessments yielding revenue of \$13.87 million.<sup>32</sup>

**4.28** The significance of ATO's detection is somewhat diminished when you consider these figures represent an average tax of \$682 per assessment, which on 1985-86 tax rates converts to a gross income of only \$7323 per annum (for 1983-84 gross income is even less — \$6868). While the Committee acknowledges a percentage of non-lodgers would be genuine low income earners, the Committee is not satisfied given the extremely low income level, that ATO has taken sufficient steps to ensure that income reported by non-lodgers is in fact a true indication of income received.

**4.29** This concern stems from an impression gained by the Committee that non-lodgers' returns on the whole, are not treated or assessed any differently to other taxpayers' returns.<sup>33</sup> Furthermore, the extent to which non-lodgers are subjected to additional investigation through tax audit appears insufficient. To date, only 1664 of the 22 297 detected non-lodgers have undergone tax audit, despite the fact that 1 in every 3 audits has resulted in additional tax revenue.<sup>34</sup> The amount of extra revenue raised and therefore the productivity of these audits is not known by the ATO.<sup>35</sup>

**4.30** Besides the problems associated with non-lodgers, the Committee is also concerned by the incidence of non-lodgement within PPS related tax returns. As explained by ATO, of the \$250m collected in 1983-84, to date approximately \$60-70m has not been applied to tax assessments.<sup>36</sup> In other words 1/4 of tax paid under PPS has not been claimed by taxpayers. Apart from suggesting individuals were well satisfied in paying tax at only 10% or 25%, it may also indicate that significant numbers of persons although liable to further taxation are delaying or avoiding payment through non-submission of tax returns.<sup>37</sup> The ATO is currently studying the revenue implications of this situation.<sup>38</sup>

<sup>32</sup> ATO, *Annual Report 1984-85*, p. 55.

<sup>33</sup> Evidence, pp. 275-276.

<sup>34</sup> ATO correspondence to the Committee 9 April 1986.

<sup>35</sup> ATO correspondence to the Committee 9 May 1986.

<sup>36</sup> Evidence, p. 35.

<sup>37</sup> Ibid.

<sup>38</sup> Ibid.

**4.31** Although PPS has been successful in gaining significant taxation revenue from traditional 'cash economy' industries, it is questionable whether its operation has been fully effective. As illustrated by the preceding examples, problems currently exist within certain facets of PPS operations, yet whether any of these has led to revenue loss is unknown, as ATO has neither estimated nor undertaken any study to determine the impact of the observed deficiencies. The Committee considers that a study of the effectiveness and cost-effectiveness of PPS is overdue and recommends that:

**Recommendation 15:** The review referred to in Recommendation 14 include an examination of the effectiveness and cost-effectiveness of the current operation of the Prescribed Payments System.

## Sales Tax

**4.32** In ATO's submission to the Committee it was indicated that deficiencies had been identified within sales tax operations during 1980. Although ATO had planned to review this area, such a review was not carried out immediately because of more pressing tasks. On being informed in September 1981 of the Auditor-General's intention to undertake an efficiency audit of this area, this review was further deferred until this audit was completed.<sup>39</sup>

**4.33** The consequent EA report, 'Collection of Sales Tax by the Australian Taxation Office' was presented to the Parliament in August 1984. Within this report the Auditor-General outlined a number of serious deficiencies within the sales tax area and suggested that inadequate action by ATO, had in fact, led to an expansion in sales tax avoidance schemes and competitive inequities favouring tax avoiders.<sup>40</sup>

**4.34** Shortly after the report's release, ATO established a Sales Tax Working Party to review all aspects of sales tax operations incorporating those points raised by the Auditor-General. This party has since produced a two volume report, the recommendations of which are currently being implemented.<sup>41</sup>

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<sup>39</sup>Submission No. 3.

<sup>40</sup>*Reports on the Auditor-General on Efficiency Audit*, p. 96.

<sup>41</sup>Evidence, p. 18.

**4.35** Although the ATO believes that no tax revenue has been lost as a result primarily of sales tax avoidance schemes, the Committee feels this was due more to good fortune than to good management.<sup>42</sup> The Committee is amazed that the ATO although having known of at least nine major deficiencies<sup>43</sup> in its sales tax operations even before the efficiency audit commenced, had not actively implemented remedial actions to redress these deficiencies before 1986.

## Income Tax Instalment Declaration Forms

**4.36** To gain the benefit of the general exemption rebate, and where applicable, the dependent rebate in the form of reduced PAYE deductions a salaried or wage earning employee is required to complete a pre-carboned income tax instalment declaration form and furnish it to his or her employer. The original of this form is countersigned by the employer and sent to the ATO while the duplicate is retained by the employer. An employee with more than one employer at any given time is only permitted to lodge a declaration with one of those employers.

**4.37** In the EA report 'Processing of Income Tax Instalment Declarations' the Auditor-General in his examination of ATO's Brisbane Branch highlighted two significant weaknesses within this area of ATO's operations. They were that:

- ATO was not carrying out any systematic or scientifically based checking of declarations, and while some were subject to scrutiny, the vast majority of declarations, without being sorted or otherwise examined were destroyed; and
- declarations made before 30 June 1983 may have ceased to have legal effect, as a result of late publication of a 'gazette notice' required under Income Tax Regulation 54 DAG.<sup>44</sup>

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<sup>42</sup>Ibid.

<sup>43</sup>Submission No. 3

<sup>44</sup>*Reports of the Auditor-General on Efficiency Audits*, pp. 54 and 59.

**4.38** Whilst the majority of declaration forms still remain unchecked ATO now pursues a far more systematic approach to the examination of these forms.<sup>45</sup> However, the Committee believes that further efforts in the detection of false declarations and particularly in the targeting of 'high risk' groups for inspection is necessary. This would appear obvious given that ATO estimates revenue loss from non-disclosure of salary and wage income to be approximately \$100m per annum, yet from 67 000 instalment inspections performed in 1984-85 only 65 employees were prosecuted for falsely completing instalment declarations to escape lawful tax liabilities.<sup>46</sup> Although the making of false declarations would only be partially responsible for this revenue loss, the success of current enforcement activities as measured by the number of prosecutions is extremely low. While recognising the deterrent value of on-site inspections, the Committee is left with the impression that more productive compliance options are available.

**4.39** One such option could be the tightening of information requirements on instalment declaration forms, particularly by making compulsory the disclosure of tax file numbers. At the moment, employees are not required to disclose their tax file number in order to receive the general tax exemption or other rebates. If disclosure of tax file numbers was compulsory an employer would deduct tax instalments at the standard rate without general exemptions or other rebates where an employee failed to disclose his or her tax file number. Such an arrangement currently exists in regard to the Prescribed Payments Scheme. While the ATO agrees this approach would significantly raise disclosure of salary and wages income, its commitment is somewhat reserved due to the costs and problems associated with implementation.<sup>47</sup> Not the least of these problems is the very low integrity of the present tax file number system.<sup>48</sup> Nonetheless, the Committee believes the ATO should seriously consider and advise Government on possible options to tighten compliance. The Committee therefore recommends that:

**Recommendation 16: The Australian Taxation Office examine alternatives to current salary and wage compliance activities, including a review of stricter disclosure**

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<sup>45</sup> ATO correspondence to the Committee, dated 9 April 1986.

<sup>46</sup> Ibid.

<sup>47</sup> Ibid.

<sup>48</sup> Aust. Card Report, p. 132.

requirements for Income Tax Instalment Declarations and advise the Government of benefits and costs of various options available to minimise tax revenue loss in this area.

4.40 The second issue raised by the Auditor-General's report hinges on a technicality. The resultant situation was described by the Auditor-General in the following manner:

Income Tax Regulation 54DAG provides that declarations furnished by an employee have effect only to the date on which the last payment of salary or wages is made to that employee before 1 July of the year next following unless the Commissioner, by notice in the Commonwealth Gazette, determines a later date to which the declarations are to remain effective. There was no notice in the Gazette of a determination by the Commissioner for this purpose during the year ended 30 June 1983.

A Gazette notice of a determination published on 5 July 1983 did not appear to revive, for the purposes of determining the amounts to be deducted as tax instalments during 1983-84, declarations that had ceased to have effect on or before 30 June 1983. It appeared to Audit, therefore, that declarations made before 30 June 1983 may have ceased to have legal effect.<sup>49</sup>

4.41 Although conjecture surrounds the legality of determining tax instalments based on declarations furnished prior to 1 July 1983, this in fact was done until issuance of new declarations in 1985. Further, several connotations were placed on this new issue, by Mr Antony Minchin of the Australian Audit Office.

MR HAWKER — There was a new [declaration] form in 1985.

Mr Minchin — Indeed, partly I think because we drew attention to the fact that there seemed to be no legal authority because of a mix-up on the ATO 'Gazette' notice in 1983. We queried the Tax office on that and it said: 'Yes, the legal position is a bit doubtful'. But to overcome it, I gather it has asked all

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<sup>49</sup> *Reports of the Auditor-General on Efficiency Audits*, p. 59.

employees to lodge a fresh lot of declarations. That gives it a massive pulping job.<sup>50</sup>

4.42 Despite requests from the Australian Audit Office, the ATO to date has not sought legal advice as to whether declarations furnished prior to 1 July 1983 were in fact, effective for the 1983–84 financial year.<sup>51</sup> In order to establish precedent in the event of any future occurrence of this situation, the Committee recommends that:

**Recommendation 17:** The Australian Taxation Office seek from the Attorney-General's Department advice as to whether the late publication on 5 July 1983 of a Commonwealth Gazette notice required under Income Tax Regulation 54DAG, legally revived Income Instalment Declarations furnished prior to 1 July 1983 for the purposes of determining the amounts to be deducted as tax instalments during the 1983–84 financial year.

## Income Tax Assessment

4.43 In the EA report 'Processing and Assessment of Income Tax Returns' the Auditor-General pointed to severe inadequacies within the current system of income tax assessment. The present system is highly labour-intensive using some 2501 staff to review and assess the 9 million income tax returns submitted annually.<sup>52</sup> Although some checking and issuing procedures have been computerised, the actual assessment of returns is performed manually. As a result, significant workloads are placed upon assessing staff (for example, nationally, assessors are expected to process 270 Salary/Wage returns per day — approximately 35 per hour)<sup>53</sup> affording little more than a cursory glance at each return.

4.44 In addition, despite the importance of the assessing process as the initial point of scrutiny and probably the most opportune time to flag returns

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<sup>50</sup>Evidence, p. 203.

<sup>51</sup>Submission No. 3.

<sup>52</sup>Evidence, pp. 9 and 19.

<sup>53</sup>ATO correspondence, 11 July 1986.

for further enquiry, the Auditor-General found assessors were strictly limited in their scope to refer returns further. As an indication, the Auditor-General stated:

Of the 1.8 million individuals' returns assessed in the Sydney Branch in 1983-84, no more than 6 had been referred by assessors during the year to the Compliance Branch for investigation or tax auditing.<sup>54</sup>

4.45 The ATO conducts a separate investigation and auditing program developed almost completely independently of the assessing function.<sup>55</sup>

4.46 Also, from the Auditor-General's viewpoint assessors appeared to have 'little information to assist in assessing the accuracy of the data supplied in tax returns.'<sup>56</sup> Overall the Committee felt that ATO's approach to income assessment was un-co ordinated and its belief in labour-intensive work practices misplaced. Evidence given to the Committee by Mr Antony Minchin of the Australian Audit Office is even more critical of ATO's assessment process: 'the report on assessing really said that because assessing was so unscientific, unsystematic and apparently ineffectual the assessors might as well be moved over to the compliance area.'<sup>57</sup> With the introduction of taxpayer self-assessment it is thought many of the deficiencies observed by the Auditor-General will be overcome, however, the Committee during its inquiries noted that current assessment procedures could also have been better had ATO taken advantage of past opportunities.

4.47 An illustration of this point is the tax file number system. This system was established for internal use in the late 1970s and was never intended to have wider application.<sup>58</sup> Although ideally suited its usage for identification purposes (as now proposed by the Australia Card Committee) had never been pursued.<sup>59</sup> Although this numbering system now suffers from very low integrity and is not considered feasible for identification purposes,

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<sup>54</sup> *Reports of the Auditor-General on Efficiency Audits*, p. 16.

<sup>55</sup> *Ibid.*

<sup>56</sup> *Ibid.*, p. 15.

<sup>57</sup> *Evidence*, p. 180.

<sup>58</sup> *Evidence*, p. 243.

<sup>59</sup> *Ibid.*

improvements could have been expected in ATO's matching capabilities especially in dividends and interest checking had the system been developed on broader parameters. Any improvements in this area would have led to increased tax revenues. Despite the tax number having wider applications, the opportunity it presented was forgone. The Commissioner of Taxation's response seems to imply as much:

CHAIRMAN — Looking back, given the circumstances of a system in which people have taxpayer numbers, do you think you have designed a system that had the optimum level of internal checks for you to be able to minimise the abuse of the tax system?

Mr Boucher — The answer to that, in short terms, must be no, because what we are suggesting to the Committee is that the optimum system is that which is proposed to be brought in, in conjunction with Australia Card. Everybody knows that those features are not present in the arrangements that we have now.<sup>60</sup>

4.48 The Committee confined its examination to ATO's current numbering system, and did not evaluate any of the alternative identification systems (for example, the Australia Card). The Committee recommends that:

**Recommendation 18: With or without the adoption of the Australia Card, the Australian Taxation Office take the necessary steps to establish a high integrity identification system which would ensure maximum taxpayer compliance.**

4.49 Although its inquiries were centred upon ATO's current assessment process, the Committee also took the opportunity to enquire into the proposed taxpayer self-assessment system. As the Committee discussed with various witnesses the proposed format and structure of self-assessment, a number of seemingly unresolved issues on the system's operation emerged.

The issues concerned are listed below:

- to date, ATO appears not to have settled on a flagging system where taxpayers requiring rulings on certain items can highlight their returns for manual assessment;<sup>61</sup>

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<sup>60</sup>Evidence, pp.241-242.

<sup>61</sup>Evidence, p. 128.



- revision of ATO's future audit objectives particularly the scope and nature of salary and wage audit activities is required prior to the introduction of taxpayer self-assessment into this area;<sup>62</sup> and
- ATO's current computer facilities and services urgently require upgrading to assist in the effective targeting of taxpayers for audit scrutiny as the ATO presently does not have a database to support its audit function.<sup>63</sup>

These particular issues are paramount to the successful operation of ATO's self-assessment process and therefore the Committee recommends:

**Recommendation 19:** In view of the introduction of self-assessment, the Australian Taxation Office (ATO) implement a taxpayer flagging and reporting system so as to allow taxpayers to highlight certain items within their returns where uncertainty exists for attention by ATO to assess the return manually.

**4.50** Under the proposed system of taxpayer self-assessment the ATO will rely heavily on its investigation and enforcement capability to ensure taxpayer compliance with existing taxation legislation. As suggested by the above-mentioned issues ATO has not settled fully its approach or procedures in relation to its enforcement activities. The findings raised, particularly the lack of an adequate database, loom as serious deficiencies within any enforcement process and must be redressed by ATO before the introduction of taxpayer self-assessment. The Committee therefore recommends that:

**Recommendation 20:** Associated with the introduction of taxpayer self-assessment, the Australian Taxation Office in developing a national compliance and enforcement capability gives priority to the implementation of a fully integrated high quality database able to facilitate efficient taxpayer selection for investigation and tax audit.

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<sup>62</sup>Evidence, p. 39.

<sup>63</sup>Evidence, p. 78.

## Chapter 5

# Conclusion

**5.1** As this inquiry progressed it became obvious to the Committee that ATO's current tax assessment and collection operations left a great deal to be desired. As outlined in the previous chapters of this report, significant weaknesses particularly within ATO's compliance and enforcement capabilities, have emerged placing doubts on ATO's ability to effectively collect all taxes due and payable.

**5.2** For example, it has been estimated that each year \$2000m. in tax revenue is lost as a result of deliberate or inadvertant understatement and non-reporting of taxpayers' incomes.<sup>1</sup> While this loss is taxpayer initiated, part of the blame lies in the inadequacy of ATO's systems. ATO is responsible for the detection of such occurrences. Because of the inadequacy of ATO's current information and checking system, the probability of detection is low and as such this form of tax evasion continues virtually unfettered.

**5.3** While the ATO has described its objective as; '*Put simply, the Taxation Office exists to gather the revenue*'<sup>2</sup> (emphasis added). It is highly doubtful whether ATO has in fact gathered all the tax revenue possible. It is also questionable whether ATO has been efficient in gathering the taxes it has received. It is therefore not unreasonable to assume that had ATO been more successful in its collection of existing taxes, the need for further taxes

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<sup>1</sup> *Reform of the Australian Tax System: Draft White Paper*, AGPS, Canberra, June 1985, p. 37.

<sup>2</sup> Australian Taxation Office, *Corporate Plan 1985-86*, Canberra, 1985, p. 5.

and higher rates of current taxes may well have been lessened, relieving in part the onus already shouldered by those who pay tax.

**5.4** The cause of ATO's current inadequacies can be attributed to the aggregation of a number of factors. The lack of computerisation intertwined with the continuation of labour intensive work practices has certainly retarded ATO's efficient operation. It is this surprising adherence to labour-intensive practices that has created many of ATO's woes. It is as though the ATO had been caught in a time warp.

**5.5** As the business community embraced advanced technologies and developed its applications, ATO has seemed unable to implement new technology becoming ever more reliant on labour oriented processing methods. Computerisation heralded an information explosion which the ATO concedes it could not handle.<sup>3</sup> As a consequence, the quality of its information reporting and checking system, so important to income tax assessment, declined. Coupled with this, excessive workloads within the assessment area reduced the assessment of returns to a flick and tick exercise.<sup>4</sup> ATO's inability to adapt its operations to a changing environment has severely compromised the effectiveness of ATO's revenue collection abilities.

**5.6** The need to implement computerisation is urgent and is somewhat reflected by the Commissioner of Taxation's comments:

The ADP Strategic Plan foreshadows a period of radical change in the utilisation of information systems technology in the ATO.<sup>5</sup>

**5.7** While the implementation of its ADP Strategic Plan may resolve some of the problems noted, ATO also needs to rethink its approach to computerisation accepting it as fundamental to its efficient operation rather than as a peripheral or complement to existing labour intensive systems. Once this revision in philosophy is adopted, the ATO will be better prepared to meet future demands and workloads placed upon it.

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<sup>3</sup>Evidence, p. 261.

<sup>4</sup>Evidence, pp.78 and 80.

<sup>5</sup>Australian Taxation Office, *ADP Strategic Plan: November 1985*, Canberra, 1985, Foreword.

**5.8** The ATO should also challenge and critically review its existing systems and operations. This became very clear during the Committee's public hearings as evidence presented certainly suggested that more cost-effective tax collection systems could be introduced. One such alternative is greater use of tax deduction at source, or withholding taxes. Although already utilised in the form of Pay As You Earn (PAYE) and Prescribed Payments System (PPS) its application to interest income has considerable advantages over the current inadequate checking system. Tax revenue loss from non-disclosure of interest income is estimated to be between \$300-500 million per annum. The implementation of a withholding tax arrangement would effectively minimise current tax evasion while considerably increasing revenue.

**5.9** Further, the Committee also strongly supports the expansion of the Prescribed Payments System to applicable industries where tax evasion through understatement of income is known to exist.

**5.10** The Committee also believes tangible benefits, particularly in the form of increased taxpayer compliance, could be achieved through the introduction of a high integrity taxpayer identification system. Such a system would lead to substantial improvements in ATO's information and checking systems and this in turn, would generate greater tax revenues through increased taxpayer compliance.

**5.11** Along with the need to consider alternative taxation mechanisms, the ATO is also aware that further operational improvements within its existing infrastructure are required. Although the ATO has squandered many of its past opportunities, this should not detract support from ATO's current attempts to revamp and modernise its taxation assessment and collection system. As significant revenue gains can be achieved by ATO's increased efficiency and effectiveness, the Committee feels ATO's current ADP and administrative initiatives should be favourably looked upon by government.

**5.12** This decline in ATO's operational efficiency appears to be closely linked to the tax scheme era of the 1970s and early 1980s. Until a decade ago, the Australian Tax System seemed virtually free from organised tax

evasion and ATO's role was largely that of a receiver, as tax revenue flowed in with only minimal collection effort.

5.13 With the creation in the mid-1970s of highly elaborate tax schemes this situation dramatically changed. Despite ATO's attempts to restrain evasion, the landmark decision in *Slutzkin's*<sup>6</sup> case in 1977 effectively nullified, in ATO's view, Section 260 of the *Income Tax Assessment Act 1936*, and with it any hope of containing tax schemes.<sup>7</sup> The floodgates opened as small-time operators flocked to join the dozen or so established promoters. This decision and others that followed (for example *Westraders*<sup>8</sup>) substantially reduced ATO's power to halt the expansion of tax schemes and, until recently, to collect the hundreds of millions foregone in taxation revenue.

5.14 As the Commissioner of Taxation told the Committee, dealing with specific tax evasion schemes became a pre-occupation within the Taxation office.<sup>9</sup> This pre-occupation obviously worked to the detriment of other taxation operations (see Chapter 4). While the impact of this era remains, ATO's earlier concentration on tax evasion has significantly reduced. In its place, the re-development of existing assessment and collection operations has become a major priority. This new direction may well counter-balance past inactivity. The Committee urges ATO to adopt a more effective and balanced approach to taxation collection.

5.15 While studying the impact tax evasion had on ATO's operations, the Committee became aware that the Commonwealth was possibly not geared up to handle the large scale prosecution prompted by the tax evasion schemes of the late 1970s and early 1980s. As stated by the Director of Public Prosecutions, Mr Ian Temby, QC:

... it is clearly the case that the Commonwealth simply was not organised to do work of this sort. The magnitude of these cases is simply breathtaking. By world standards they are enormous and you have to be very, very specially organised to do it and

<sup>6</sup> Australian Law Reports, 1977 Vol, 12. p. 321.

<sup>7</sup> Evidence, p. 288.

<sup>8</sup> Australian Law Reports, 1980, Vol. 30. p. 353.

<sup>9</sup> Evidence, p. 6.

the Commonwealth simply never was. Criminal law in the Commonwealth area 10 years ago was a quite backwater.<sup>10</sup>

5.16 It also appears from evidence given by the Commissioner of Taxation that the Attorney-General's Department, despite pleas from the ATO, was tardy in the early stages in bringing action against alleged tax promoters under existing law, in particular the *Crimes Act 1914*.<sup>11</sup> In its defence, the Attorney-General's Department has indicated that such attempts may well have been unsuccessful, particularly given the strict legalistic approach followed by some Courts at the time.<sup>12</sup> It was also thought that promoters had organised their arrangements to minimise any risk of prosecution under section 86 of the *Crimes Act 1914*. This was done by ensuring that parties to 'straw' company schemes knew as little as possible of the overall arrangements.<sup>13</sup>

5.17 This reasoning now appears invalid. The following exchange during evidence appears to substantiate this point:

Mr McLEAY — Some people have said that the only reason you can now operate and users of the bottom of the harbour schemes can be prosecuted is that the law was changed.

Mr Temby — That is simply wrong. The charges which have been laid are charges which were always available. If there were any charges under the new legislation — what is called in the trade the T(UCT) legislation — they are few. There might be a handful of charges laid, and to be laid, under the new legislation, but 90 per cent of the work which we have done in our major fraud area is certainly based on the old legislation and quite old fashioned notions as to what fraud is.

Mr HAWKER — When you say, 'old', how old would you mean?

Mr Temby — It would be 1910 or 1920 or whatever - the Crimes Act, and conspiracy under the Crimes Act.<sup>14</sup>

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<sup>10</sup>Evidence, p. 168.

<sup>11</sup>Evidence, p. 286.

<sup>12</sup>Exhibit No. 13, p. 4.

<sup>13</sup>Ibid., p. 3.

<sup>14</sup>Evidence, pp. 167-168.

5.18 Although significant in itself, this situation appears symptomatic of a more fundamental problem. As suggested by various witnesses, past co-ordination between Commonwealth Departments in tackling tax schemes has been at best ineffective, at worst non-existent. This apparent liaison difficulty, in some cases, led to bodies working in splendid isolation of one another. A great deal of effort may well have been wasted as a result.<sup>15</sup>

5.19 These past difficulties are not insoluble and indications suggest the current situation is greatly improved. To this effect, the Committee endorses the relationship and co-ordinated effort now evident from the three major bodies involved — the Australian Federal Police, ATO and the Office of the Director of Public Prosecutions.

5.20 From evidence taken by the Committee, the increasing complexity of and possible ambiguity within existing taxation legislation has become a significant concern not only for the ATO but also for major accounting organisations.<sup>16</sup> Although taxation law is literally quite specific, the problem lies in its interpretation to real world commercial situations. While the Committee has not fully examined the major tax laws, the evidence provided to it strongly suggests that some review by ATO of existing taxation law and in particular the *Income Tax Assessment Act 1936* is urgently required. The Committee therefore recommends that:

**Recommendation 21: The Australian Taxation Office undertake a comprehensive review of the *Income Tax Assessment Act 1936*. Where provisions are found to be ambiguous or in need of amendment advise the Government accordingly as to the appropriate actions necessary.**

5.21 By examining the five EA's conducted by the Auditor-General, the Committee gained considerable insight into the infrastructure associated with taxation assessment and collection in Australia. As this inquiry progressed, it became apparent to the Committee that fundamental deficiencies existed within ATO's operations. These deficiencies reflected ATO's

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<sup>15</sup>Evidence, p. 163.

<sup>16</sup>Evidence, pp. 42, 100 and 112.

adherence to antiquated philosophies in a period where dramatic change occurred. There is no doubt ATO's efficiency and effectiveness have suffered as a result and almost certainly significant taxation revenues have been lost. While the Committee acknowledges ATO's current attempts in rectifying these problems, it is felt such actions were possible far sooner than ATO wishes to admit. It is within this context that the Committee is most disappointed with ATO's operations. In order for ATO to effectively discharge its responsibilities substantial operational improvements are necessary. The Committee eagerly awaits their implementation.

**John Mountford MP**  
**Chairman**  
**25 September 1986**



# Appendix I

## Witnesses

	<b>Dates of Appearance Before Committee at Public Hearings</b>
Mr Trevor Percy Winston Boucher, Commissioner of Taxation, Australian Taxation Office, Canberra, Australian Capital Territory	12.3.86 18.3.86
Mr John Leslie Harwood, Assistant Commissioner, Sales Tax Branch, Australian Taxation Office, Canberra, Australian Capital Territory	12.3.86 18.3.86
Mr Richard Highfield, Acting Assistant Commissioner, National Projects Branch, Australian Taxation Office, Canberra, Australian Capital Territory	12.3.86 18.3.86
Mr Ronald Gordon Mills, Acting First Assistant Commissioner, Australian Taxation Office, Canberra, Australian Capital Territory	12.3.86 18.3.86
Mr Desmond Joseph Black, Second Commissioner, Australian Taxation Office, Canberra, Australian Capital Territory	12.3.86 18.3.86
Mr Alan Sirr, Senior Assistant Commissioner, Public Service Board, Canberra, Australian Capital Territory	12.3.86
Mr Brian Thornton, Assistant Secretary, Staff Budgeting, Department of Finance, Canberra, Australian Capital Territory	12.3.86

- Mr Brian Joseph Gleeson, Acting Assistant Secretary, 12.3.86  
 Department of Finance, Canberra, Australian Capital Territory
- Mr Stephen Francis Prytz, Industrial Officer, 12.3.86  
 Administrative and Clerical Officers' Association,  
 3rd Floor, 245 Castlereagh Street, Sydney,  
 New South Wales
- Mr Ian Churchill Latham, Industrial Officer, 12.3.86  
 Administrative and Clerical Officers' Association,  
 3rd Floor, 245 Castlereagh Street, Sydney,  
 New South Wales
- Mr Brian Robert Norris, Chairman of the Tax Panel, 12.3.86  
 Institute of Chartered Accountants in Australia,  
 27 York Street, Sydney, New South Wales
- Mr Ian Douglas Temby, QC, Director of Public 13.3.86  
 Prosecutions, Canberra, Australian Capital Territory
- Mr John Vincent Monaghan, Auditor-General, 13.3.86  
 Australian Audit Office, Canberra,  
 Australian Capital Territory
- Mr Cyril Thomas Monaghan, First Assistant 13.3.86  
 Auditor-General, Australian Audit Office,  
 Canberra, Australian Capital Territory
- Mr Antony St John Minchin, Acting Assistant 13.3.86  
 Auditor-General, Australian Audit Office,  
 Canberra, Australian Capital Territory
- Mr Michael John Jacobs, Acting Regional Manager, 13.3.86  
 Australian Capital Territory, Australian Audit  
 Office, Canberra, Australian Capital Territory

Mr James Michael Killaly, Assistant Commissioner,  
Australian Taxation Office, Canberra, Australian  
Capital Territory

18.3.86

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# Appendix III

## Index of Exhibits

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1.	Exhibit, Canberra 12 March 1986 - Decision Making in the Australian Tax System, Parts I and II, Australian Tax Research Foundation.
2.	Exhibit, Canberra 12 March 1986 - Australian Taxation Office Work Volumes and Resource Levels, 1973-74 to 1982-83.
3.	Exhibit, Canberra 12 March 1986 - Text of speech to Australian Society of Accountants on practicalities of self-assessment, by Mr Trevor Boucher, Commissioner of Taxation.
4.	Exhibit, Canberra 12 March 1986 - Australian Taxation Office ADP Strategic Plan, November 1985.
5.	Exhibit, Canberra 12 March 1986 - Australian Taxation Office Corporate Plan 1985-86.
6.	Exhibit, Canberra 18 March 1986 - Australian Taxation Office Resource Utilisation Plan 1984-85.
7.	Exhibit, Canberra 18 March 1986 - Policy on Staff Development and Training, June 1985. (Australian Taxation Office)
8.	Exhibit, Canberra 18 March 1986 - Company Tax Statistics 1975-76 to 1985-86. (Australian Taxation Office)

9. Exhibit, Canberra 18 March 1986 - Taxation Ruling No. IT 2165, Arbitrary Limits Section 51 Deductions year ended 30 June 1985. (Australian Taxation Office)
10. Exhibit, Canberra 18 March 1986 - Estimated Allocation of ATO Resources for Processing Income Tax Returns, year ending 30 June 1986. (Australian Taxation Office)
11. Exhibit, Canberra 18 March 1986, Estimated Allocation of ATO Resources for Other Activities, year ending 30 June 1986.
12. Exhibit, Canberra 30 April 1986, Supplementary information sought from Australian Taxation Office at Public Hearing on 18 March 1986.
13. Exhibit, Canberra 8 May 1986, Supplementary information to letter dated 15 April from Mr P. Brazil, Secretary, Attorney-General's Department.

