

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

## A TALE OF THREE CITIES

A REVIEW OF AN EFFICIENCY AUDIT OF THE  
AUSTRALIAN TAXATION OFFICE

TAXPAYERS IN UNINCORPORATED BUSINESSES

THE HOUSE OF REPRESENTATIVES  
STANDING COMMITTEE ON  
FINANCE AND PUBLIC ADMINISTRATION

NOVEMBER 1988

Australian Government Publishing Service  
Canberra

© Commonwealth of Australia 1988  
ISBN 0 644 09015 4

**THE PARLIAMENT OF THE  
COMMONWEALTH OF AUSTRALIA  
PARLIAMENTARY PAPER**

**No. 379 OF 1988**

**Ordered to be printed  
by authority  
ISSN 0727-4181**

## FOREWORD

This report is a review of an efficiency audit report into the Australian Taxation Office. It is the seventh efficiency audit report to be reviewed by the Finance and Public Administration Committee.

The Committee's report, 'A Taxing Review', presented in May of this year reviewed six efficiency audits. The House of Representatives Standing Committee on Expenditure in September 1986 presented a report on five earlier audits of the Australian Taxation Office.

Three members of the sub-committee which conducted this inquiry, Deputy Chairman of the Committee, Hon. I.B.C. Wilson, Mr D.W. Simmons and myself were members of the earlier sub-committees.

Over the period of the inquiries we have gained an insight into the operations of the ATO and an understanding of taxation policy. Members of the sub-committees have visited the Adelaide, Brisbane, Darwin, Hobart, Melbourne, Perth and Townsville offices of the ATO. During the course of the visits we were able to have informal discussions with ATO staff and observe ATO operations.

The Commissioner for Taxation, Mr Boucher has appeared before the Committee at four public hearings and in total some 15 officers of the ATO have appeared at the six public hearings.

We can thus claim to have some expertise in taxation matters. This report reflects that expertise.

I take this opportunity to record the Committee's appreciation of the work of the project officer for the inquiry, Anne Hazelton.



STEPHEN MARTIN, MP  
CHAIRMAN

## TERMS OF REFERENCE OF THE COMMITTEE

The Standing Committee on Finance and Public Administration is empowered to inquire into and report on any matters referred to it by either the House or a Minister including any pre-legislation proposal, bill, motion, petition, vote or expenditure, other financial matter, report or paper.

On 7 December 1987 the House agreed -

That the report upon an efficiency audit of the Australian Taxation Office: Taxpayers in unincorporated businesses be referred to the Standing Committee on Finance and Public Administration.

## MEMBERSHIP OF THE COMMITTEE

Chairman: Mr S.P. Martin, MP

Deputy Chairman: Hon. I.B.C. Wilson, MP

Members:

- Mr R.A. Braithwaite, MP
- Dr R.I. Charlesworth, MP
- Mr M.R. Cobb, MP
- Mr B.W. Courtice, MP
- Mr G. Gear, MP
- Dr J.R. Hewson, MP (until 20 October)
- Mr H.A. Jenkins, MP
- Mr F.S. McArthur, MP
- Mr J. Saunderson, MP
- Mr R.F. Shipton, MP (from 20 October)
- Mr D.W. Simmons, MP

Secretary: Mr P.F. Bergin

## MEMBERSHIP OF THE SUB-COMMITTEE

Chairman: Mr S.P. Martin, MP

Members:

- Mr R.A. Braithwaite, MP
- Dr R.I. Charlesworth, MP
- Mr D.W. Simmons, MP
- Hon. I.B.C. Wilson, MP

Secretary: Mr P.F. Bergin

Inquiry Staff:

- Ms A. Hazelton
- Mr C. Hodges
- Ms K. Buckley
- Ms S. Fisher



## TABLE OF CONTENTS

|                                                  | page      |
|--------------------------------------------------|-----------|
| Abbreviations                                    | viii      |
| Summary of the Committee's Findings              | ix        |
|                                                  | paragraph |
| Chapter 1 - Introduction                         |           |
| . Background                                     | 1.1       |
| . Aim of the Report                              | 1.2       |
| . Conduct of the Review                          | 1.3       |
| . A Taxing Problem                               | 1.4       |
| . A Taxing Review                                | 1.5       |
| Chapter 2 - The Audit Report                     |           |
| . Background                                     | 2.1       |
| . Conduct of the Audit                           | 2.2       |
| . Findings of the Audit Report                   | 2.3       |
| . Response to the Report                         | 2.4       |
| Chapter 3 - Impact of the Report                 |           |
| . Background                                     | 3.1       |
| . Results of the Audit                           | 3.2       |
| . Future ATO Activity                            | 3.3       |
| . Usefulness of the Report                       | 3.4       |
| Chapter 4 - Taxpayer Identification              |           |
| . Background                                     | 4.1       |
| . Dividends and Interest                         | 4.2       |
| . Recent Proposals                               | 4.3       |
| . Privacy Considerations                         | 4.4       |
| . Previous Considerations                        | 4.5       |
| Chapter 5 - Other Issues                         |           |
| . Background                                     | 5.1       |
| . Non-Lodgers and Late Lodgers                   | 5.2       |
| . Tax Amnesty                                    | 5.3       |
| . Extension of the Prescribed<br>Payments System | 5.4       |
| . Case Selection                                 | 5.5       |
| . Self Assessment                                | 5.6       |
| . Summary                                        | 5.7       |
| Chapter 6 - Overview                             | 6.1       |

## ABBREVIATIONS

|      |                                                                                     |
|------|-------------------------------------------------------------------------------------|
| AAO  | Australian Audit Office                                                             |
| ATO  | Australian Taxation Office                                                          |
| EA   | Efficiency Audit                                                                    |
| F&PA | House of Representatives Standing Committee on<br>Finance and Public Administration |
| NTS  | National Taxpayers System                                                           |
| PAYE | Pay as you earn                                                                     |
| PPS  | Prescribed Payments System                                                          |
| TUB  | Taxpayers in unincorporated businesses                                              |



## SUMMARY OF THE COMMITTEE'S FINDINGS

### The Committee -

CONSIDERS THE AUDIT REPORT HAS MADE A CONTRIBUTION TOWARDS ENSURING MAXIMUM TAXPAYER COMPLIANCE. (CHAPTER 3)

ENDORSES THE ATO POLICY OF CONCENTRATING ON THE BIG END OF THE MARKET. (CHAPTERS 3 AND 5)

DRAWS ATTENTION TO RECOMMENDATION 44 OF THE AUDIT REPORT:

The AAO recommends that the ATO develop a high integrity unique identification system for all taxpayers which will provide full cross-referencing of relationships among companies, partnerships, trusts and individual taxpayers including those whom the ATO exempts from having to lodge returns. This index should be readily accessible to ATO officers in their compliance activities and should be exploited fully by automated procedures in such routine processes as the issuing of assessment notices and the analysis of lodgment histories;

and that

The AAO sees the most important priority for the ATO as being the development of high integrity unique identifiers for all taxpayers ... (para 11.6).

AND TO AN EARLIER RECOMMENDATION OF THE COMMITTEE:

That the ATO take the necessary steps to establish a high integrity identification system which would ensure maximum taxpayer compliance.

Recommendation 13 of 'A Taxing Review' (May 1988).

Recommendation 18 of 'A Taxing Problem' (November 1986).

AND CONCLUDES THAT THE DEVELOPMENT OF A HIGH INTEGRITY UNIQUE IDENTIFICATION SYSTEM IS AN IMPORTANT PRIORITY. (CHAPTER 4)

WELCOMES THE INITIATIVES TAKEN WITHIN THE ATO. (CHAPTER 5)



## CHAPTER 1

### INTRODUCTION

#### 1.1 Background

- 1.1.1 This Report examines an Efficiency Audit (EA) report of the Auditor-General of the Australian Taxation Office (ATO): Taxpayers in unincorporated businesses (TUB). It is the seventh audit report to be reviewed by the House of Representatives Standing Committee on Finance and Public Administration (F&PA).

#### 1.2 Aim of the Report

- 1.2.1 As with earlier reviews of EAs by the former Expenditure Committee and the Finance and Public Administration Committee, the aim of the review was to:

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

#### 1.3 Conduct of the Review

- 1.3.1 In accordance with established practice the Committee appointed a sub-committee to conduct the inquiry.

## 2.

1.3.2 Submissions were accordingly sought and received from the Australian Taxation Office and the Australian Audit Office (AAO).

1.3.3 Evidence was taken at public hearings in Brisbane on 23 June and Hobart on 27 July. Inspections of the Brisbane, Townsville and Hobart Branches of the ATO were conducted during June and July 1988.

1.3.4 Details of witnesses who appeared at public hearings and of submissions authorised for publication are included in Appendixes I and II respectively.

1.3.5 As is customary, the transcripts of the public hearings and other evidence authorised for publication have been incorporated in separate volumes and copies are available for inspection in the Committee Secretariat and the Parliamentary Library. References to evidence in the text of this Report relate to page numbers in those volumes. F&PA had access to the evidence and records of the Expenditure Committee which had conducted the earlier inquiries into efficiency audits of the ATO through the provisions of sessional order 28B.

### 1.4 A Taxing Problem

1.4.1 In 1985 and 1986, the Expenditure Committee undertook a review similar to the present exercise and examined five EAs of the ATO which had been presented to the Parliament in August 1984 and February 1985. The Committee's review Report, 'A Taxing Problem', was presented in the House of Representatives on 11 November 1986.

1.4.2 The Report contained twenty-one recommendations which addressed the form and content of the EA Reports as well as issues relating to aspects of management and administration in the ATO. The Government's response to that Report was presented in the House on 26 February 1987.

## 1.5 A Taxing Review

1.5.1 The Expenditure Committee commenced an examination of six Efficiency Audits of the Australian Taxation Office which had examined the following programs:

- . The Prescribed Payments System;
- . Unpresented Group Certificates;
- . External Sources of Information;
- . Disclosure of Diesel Fuel Rebates;
- . Partnership and Trust Distributions, and
- . Late Lodgement Penalties.

1.5.2 The review of the six EAs had not been completed when the 34th Parliament was dissolved in June 1987. With the aim of finalising the review following the appointment of F&PA in the 35th Parliament, the six EAs were referred to this Committee by the Treasurer on 26 November 1987. The Committee's report was tabled on Thursday, 19 May 1988 and contained 16 recommendations. When tabling the report the Chairman noted that it was difficult to isolate the specifics of the six audit reports from the general administration of the Australian Taxation Office.

## CHAPTER 2

### THE AUDIT REPORT

#### 2.1 Background

2.1.1 The Audit began in November 1985 and was tabled in the House of Representatives on 7 December 1987. The cost of the audit was \$320,864 and involved audit staff from the Adelaide, Brisbane, Hobart and Canberra offices. AAO suggested that:

'One of the underlying reasons for the cost was the protracted nature of inquiries in tracing related tax paying entities, particularly in the home units. Often whilst the home unit might physically have been in Queensland, the taxpayer would be lodged in a different State, and there were difficulties in tracking down the place where those returns were lodged, and then in identifying whether in fact returns had or had not been lodged'. (pg 46)

2.1.2 The objectives of the audit were to assess:

- (a) the success of the Taxation Office in ensuring that taxpayers associated with unincorporated businesses were in the tax net, and
- (b) the ATO's success in obtaining complete and accurate tax returns from these taxpayers.

## 2.2 Conduct of the Audit

2.2.1 To achieve these objectives, Audit chose three industries containing predominantly provisional taxpayers from which it selected a sample of taxpayers and examined their income tax returns. The industries chosen were:

- . Queensland holiday units;
- . Hobart restaurants, and
- . Canberra builders.

2.2.2 ATO noted that TUB covered 'people in all sorts of business activity' (pg 10) and that:

'It covers professionals, it covers primary producers, it covers contractors in building and construction, it virtually covers the whole gamut, of business activity.' (pg 11)

2.2.3 The Audit Office also reviewed the activities of the Enforcement Co-ordination Branch in National Office, the way in which cases were selected and monitored in the States (by sampling the procedures in the Adelaide Branch Office), and the processing of provisional tax variations.

2.2.4 In addition, the ATO's performance in relation to the checking of dividends and interest was reviewed by the Audit Office. This issue was examined and reported on by the Audit Office in 1984 and was reviewed by the Expenditure Committee in its Report, 'A Taxing Problem' in 1986. The issue was re-examined by Audit during its TUB review in order to assess the effectiveness of the ATO's current approach.

2.3 **Findings of the Audit Report**

2.3.1 The Report makes a number of findings and recommendations. However, they have now lost much of their relevance because of initiatives undertaken by the ATO both during and after the audit.

2.3.2 The Report contains 54 recommendations. The ATO has either agreed with most of these or has indicated that they are accepted practice:

'Virtually all ... have been acted upon either prior to or following Audit's report'. (pg 7)

2.3.3 Audit noted:

'I think it is probably fair to say that the Tax Office has picked up, as you say, most of the recommendations. As for other recommendations, while they have not been picked up, the changes to the arrangements in the Tax Office have effectively picked up the sense of them'. (pg 71)

2.3.4 The basic thrust of the audit was to ascertain the effectiveness of all ATO functions associated with individuals who should be paying provisional tax i.e. taxpayers associated with unincorporated businesses. These functions include assessment, investigation, industry coverage and estimation of the extent of evasion practices. (paras 1.1.1 and 2.1.1)

2.3.5 Provisional tax is paid by individuals, taxable trusts and some superannuation funds which earn more than \$1000 of taxable income from sources other than those subject



to the pay-as-you-earn (PAYE) system. The AAO found that taxpayers made extensive use of partnerships, trusts and companies (some as non-trading trustee companies), in the administration of their affairs. In the AAO's view this stratagem, together with the interstate nature of many of the dealings, makes it a difficult and tortuous task to trace the source and route of funds.

(para 1.2.1)

## 2.4 Response to the Report

2.4.1 In its submission of 23 December 1987, the Australian Audit Office notes the increasing efforts by the ATO to improve its performance and mentions specific ATO initiatives.

2.4.2 AAO went on to comment that 'the whole basis of systems which were operative at the commencement of the (TUB) audit has been changed and that the evidence to be elicited from further inquiries into this audit ... may not be as helpful to administrative improvement as inquiries into the International Profit Shifting report ...'. (Audit submission)

2.4.3 The ATO makes a similar comment in its submission of 8 April 1988, and notes that ... 'given the timing of the study and the events that have since transpired, it is difficult for us to comment on its (i.e. the EA's) relevance to our present day operations.'  
(Submission pg 1)

2.4.4 Audit did note however that it had changed its focus during the course of the audit:

'We altered the focus of the audit during the audit. There were two options - one, I guess, would have been to shut the audit down and the other was to sit back and have a think about if we could re-focus the audit and come up with useful objectives. We took the latter course, and I believe we came up with useful recommendations for the Tax Office'. (pg 46)

## CHAPTER 3

### IMPACT OF THE REPORT

#### 3.1 Background

- 3.1.1 The ATO acknowledged that a range of areas identified by the AAO and itself needed improvement. One such area was case selection. Improved case selection meant a reduced focus on the unincorporated business sector. Less ATO resources would now be concentrated on the unincorporated business sector and future concentration would be on the top end of the audit market; that is the large corporate sector.
- 3.1.2 According to the ATO the Audit report confirmed this strategy as appropriate. It disclosed difficulties in tracing taxpayers but provided little or no basis for evaluating how efficient and effective the ATO is in ensuring compliance.
- 3.1.3 The ATO went on to claim that 'what the report did do was provide fairly substantial evidence of the move to self assessment'.
- 3.1.4 As noted earlier the ATO has 'picked up most of the recommendations', and 'the inadequacies and deficiencies revealed at the time the follow-up work was carried out have already been addressed or are being addressed'. (pg 2)

### 3.2 Results of the Audit

- 3.2.1 Included in the Audit report is a table which summarises the information available at the time of publication on the cases referred to the ATO for investigative action.
- 3.2.2 The table gave the omitted income as \$3.4m and the additional tax and penalty as \$2.7m. Of those amounts, the Brisbane project amounted to \$3.2m in omitted income and \$2.5m in additional tax and penalty.
- 3.2.3 An updated table was submitted by the ATO at the Hobart hearing. The table, which is set out below, shows omitted income of \$4.5m and additional tax and penalty of \$3.3m.

#### UPDATE OF TABLE AT PARAGRAPH 1.2.2. OF THE EA REPORT

| Date of Last Report                   | Canberra<br>16/09/87 | Brisbane<br>16/06/88 | Hobart<br>20/07/88 | Total     |
|---------------------------------------|----------------------|----------------------|--------------------|-----------|
| No. cases referred                    | 6                    | 75                   | 44                 | 125       |
| No. investigated by<br>the ATO        | 6                    | 68                   | 22                 | 96        |
| No. unfinished                        | 0                    | 7                    | 6                  | 13        |
| No. finished                          | 6                    | 61                   | 16                 | 83        |
| No. unproductive                      | 2                    | 28                   | 6                  | 36        |
| No. otherwise addressed by<br>the ATO | 0                    | 7                    | 22                 | 29        |
| No. finished                          | 0                    | 7                    | 22                 | 29        |
| No. unproductive                      | 0                    | 7                    | 22                 | 29        |
| Omitted income (\$)                   | 259,468              | 3,999,109            | 275,833            | 4,534,410 |
| Additional tax & penalty(\$)          | 190,505              | 2,913,748            | 232,646            | 3,336,899 |

*Source: Transcripts of Evidence, (pg 78).*

- 3.2.4 The audit yielded additional tax and penalties of \$3,336,899. However the ATO suggested that the results were well short of what had been achieved in other projects. The \$ per audit hour figure, a fairly crude measure, but according to the ATO a guide, was \$296 per hour for the Brisbane project. The ATO's average for such projects is \$363 per hour. By comparison, the results for the Hobart and Canberra projects were \$67 and \$141 per hour respectively.
- 3.2.5 The project was successful, particularly in Brisbane, but the reason that it was so successful is that it brought to light other undisclosed income. It confirmed a suggestion that lifestyle assets do give an indication of wealth above the norm:

'expensive lifestyle assets are indicators of possible understatement of income.'

(Transcript pg 9)

### 3.3 Future ATO Activity

- 3.3.1 As noted earlier the ATO proposes to reduce its concentration on the unincorporated business sector. This does not indicate that the area will be neglected. ATO advised:

'we do still maintain an audit force of about 800 auditors nationally that, by and large, will be directed at our unincorporated business sector'.  
(pg 20)

- 3.3.2 During the course of the hearings, the ATO referred to investigations that had been or were to be conducted

into particular parts of the unincorporated business sector. In addition to the owners of prestige vehicles, particular targets were:

- . Abalone Fishermen;
- . Barristers;
- . Plumbers;
- . Racing Industry;
- . Real Estate;
- . Rental Industry, and
- . Solicitors.

### 3.4 Usefulness of the Report

3.4.1 The report, without including appendices, ran to 90 pages of text and is the largest of the 13 Audit reports on the ATO. It compares with the reports on International Profit Shifting (84 pages), The Prescribed Payments System (58 pages) and the Unpresented Group Certificates (26 pages). However the AAO admitted at the public hearing that 'had we been considering the audit now, we may well not have done it'. (pg 74)

3.4.2 The value of the report lies in the information it has provided on the changes which have taken place within the ATO since the audit was designated. The audit provided fairly substantial evidence in support of the move towards self assessment and then went on to identify the most important priority for the ATO as being the development of high integrity unique identifiers for all taxpayers.

3.4.3 Another factor is the support that it gives for the decision by the ATO to concentrate on the top end of the market.

3.4.4 In summary the Committee considers the Audit report has made a contribution towards ensuring maximum taxpayer compliance. It has also suggested ways of enhancing the ATO's taxpayer compliance strategy.

## CHAPTER 4

### TAXPAYER IDENTIFICATION

#### 4.1 Background

- 4.1.1 The Audit report noted that the ATO had difficulty in matching the names of taxpayers with information provided from external sources. The index to the National Taxpayer System (NTS) consists of microfiche records, on a State basis, of all taxpayers lodging returns. Audit went on to claim:

'The NTS records are the core of the system and it is essential that they be accurate and readily accessible'. (para 7.2.1)

- 4.1.2 Audit then referred to difficulties in tracing records of associates of the individuals selected and made reference to trusts, trustees, beneficiaries, partners, spouses and business names and suggested that problems of identification will continue'. (para 7.2.5)

- 4.1.3 AAO went on to recommend:

#### *Recommendation 44*

The AAO recommends that the ATO develop a high integrity unique identification system for all taxpayers which will provide full cross-referencing of relationships among companies, partnerships, trusts and individual taxpayers including those

whom the ATO exempts from having to lodge returns. This index should be readily accessible to ATO officers in their compliance activities and should be exploited fully by automated procedures in such routine processes as the issuing of assessment notices and the analysis of lodgement histories.

4.1.4 The development of high integrity unique identifiers for all taxpayers was seen by the AAO as 'the most important priority for the ATO'. (para 11.6)

4.1.5 At a public hearing the AAO advised that 'our recommendation that the question of a high integrity unique identifier would assist in this process still stands' (pg 44) and that the unique identifier was 'a very useful administrative means'. (pg 71)

#### 4.2 *Dividends and Interest*

4.2.1 The Income Matching System has, according to Audit, improved the ATO's ability to track income not declared. However the system still has some shortcomings.

4.2.2 The ATO advised that the purpose of the new arrangements to extend the use of the tax file number is 'to improve the efficiency of the ATO's income matching system under which income reports such as those for interest ... are matched with taxpayers returns.' (pg 5)

4.2.3 At present some 30 percent of interest reports received by the ATO, which represent around 3.2 million reports, are unmatched each year. Some of the information submitted was not in a machine readable form and this necessitated a lot of reprocessing or keying within the Tax Office.



4.2.4 Audit suggested that there was also difficulty in matching the information because the ATO was still limited to matching it on a name and address basis. Even a minor spelling error in a name or address could result at the worst in a complete non-match, or it could result in further checking to establish whether or not it was a true match. (pg 53)

4.2.5 The Audit comments were supported by the ATO which suggested that a unique identifier would make its task of matching the information received with individual taxpayers much easier. Because of the difficulties associated with having to match on name and address criteria the ATO did not attempt to match investment income reports to partnership and trust records or even corporate records.

4.2.6 A unique identifier for all taxpayers was, according to the AAO, the best administrative solution for the Tax Office.

#### 4.3 Recent Proposals

4.3.1 The proposals outlined in the 1988 May Economic Statement would, it was suggested, improve the efficiency of the ATO's income matching system. The arrangement would provide the ATO with a much improved capability to ensure the disclosure of all investment income.

4.3.2 In response to a question on whether a withholding tax or a prescribed payments tax would achieve a higher level of compliance, AAO advised 'with a withholding prescribed payments system, you might achieve 100 per cent compliance'. (Transcript pg 55)

4.3.3 The May 1988 proposals, the Committee was informed:

'enable systematic matching by computer of interest reports for partnership, trust and corporate tax returns, a process presently not attempted because of the inherent difficulties associated with name and address matching. It will also provide information on investments that may lead to the detection of other categories of undisclosed income. The ATO's ability to detect non-lodgers will also be enhanced ... introduction of the new arrangements will go a long way to eliminating many of the deficiencies noted in previous efficiency audit reports covering interest and dividend matching and unrepresented group certificates'. (Transcript pg 5)

4.3.4 Audit suggested that the ability of the ATO to match all interest payments by institutions should encourage a much higher level of voluntary compliance.

#### 4.4 Privacy Considerations

4.4.1 The AAO representatives suggested that it was for the Government and the Parliament to resolve the privacy and civil liberties consideration of the tax file number proposal. There is a need to 'weigh these costs against what might be lost in terms of having an administrative second best solution'. (Transcript pg 63)

4.4.2 In response to questions on guidelines, the ATO advised it had undertaken a number of measures to strengthen security. Reference was made to passwords and the requirement for officers of the ATO to take an oath of secrecy.

4.4.3 It was stated:

'The Government proposals regarding the tax file numbers are only limited to areas currently subject to information reporting to the Tax Office, essentially salary and wages, dividends and interest, unit trust income and income subject to the prescribed payment system'. (pg 32)

4.4.4 The information on the tax file number would only be available from a few terminals in a restricted area.

4.5 Previous Considerations

4.5.1 Two earlier reports, one of this Committee 'A Taxing Review' and one of its predecessor the Expenditure Committee 'A Taxing Problem', recommended that the ATO take the necessary steps to establish a high integrity identification system which would ensure maximum taxpayer compliance.

4.5.2 The Committee continues to support those recommendations and draws attention to the suggestion in the Audit report that the most important priority is the development of high integrity unique identifiers for all taxpayers.

## CHAPTER 5

### OTHER ISSUES

#### 5.1 Background

- 5.1.1 There were a number of issues which were common to the three investigations undertaken by the AAO. The first of these concerned a national taxpayer system and was dealt with in the previous Chapter. Some of the other issues identified by AAO and pursued at the public hearings are dealt with in this Chapter.

#### 5.2 Non-lodgers and Late Lodgers

- 5.2.1 The Audit report suggested that the follow-up of non and late lodgers had been inadequate and Audit later suggested that this was an area where a concentration of deficiencies was noted. Reference was made to the non-lodgers not being actively pursued and it was noted that:

7.3.4. The ATO's practice of not following up lodgement for taxpayers assigned low tax levels resulted in a previously assigned level remaining unchanged for some years regardless of the possibility of the taxpayer's income varying significantly.

- 5.2.2 The ATO admitted that ... 'we do not have current information available in a systematic form which enables us to say with any degree of authority that a taxpayer has a liability to lodge a return'. (Transcript pg 23)
- 5.2.3 A non-lodgers' strategy has since been developed by the ATO. A major review of lodgement enforcement activities was conducted during 1987 and a major project on non-lodgers was launched. The project was aimed at 'taxpayers for whom we have a tax record but who have not lodged a return, either recently or at all, and those taxpayers for whom we have no record'.
- 5.2.4 As a result of a non-lodger detection program 1500 taxpayers were identified as not having lodged returns with a potential tax bill of \$6.9m.
- 5.2.5 There is also a spin off from the ATO's general audit activities and reference was made to a project in Brisbane where 188 former non-lodgers who owed about \$4.5m were identified.
- 5.2.6 At the hearing in Hobart AAO acknowledged that the ATO has improved them a lot and is still working to improving them. (The identification of non-lodgers.) (Transcript pg 65)

### 5.3 Tax Amnesty

- 5.3.1 As a result of the lodgement enforcement review, the ATO announced on 2 June a Tax Amnesty. The aim of the amnesty was to bring new taxpayers into the tax net and to encourage former taxpayers, with an inconsistent lodgement history, back into the taxation system. The

amnesty, which would run for five months, meant that lodgers would be free from late lodgement penalty. At the July hearing the sub-committee was advised that 'something like 19,000 taxpayers had, by then, lodged what were considered to be amnesty returns - about 38,000 returns.' (Transcript pg 107)

5.3.2 The amnesty is 'a forerunner of stiffer penalties as part of this lodgement enforcement package ... with greater demand and prosecution activities at the end of the amnesty.' (Transcript pg 107) It had received a very positive reaction from the general public and the media.

5.3.3 As noted in the Audit report, the ATO allocated an additional 60 staff to implement its new strategy for the detection of non-lodgers.

#### 5.4 Extension of the Prescribed Payments System

5.4.1 As noted earlier the Committee raised the issue of the introduction of a prescribed payment or withholding tax system to interest payments.

5.4.2 The Prescribed Payments System (PPS) is regarded by the ATO as an outstanding success and a significant success in tax administration:

'In 1987-88 collections from PPS source deductions are expected to be around \$935m, which is up 22 per cent on the prior years. The ATO also expects to present a submission to government during 1988-89 for extension of the Prescribed Payments System to other industries.' (pg 6)

5.4.3 While acknowledging that the Prescribed Payments System has been a success the Committee in its previous report referred to evidence given by the Housing Industry Association which suggested that the PPS has enabled sub-contractors to meet their provisional tax payments more easily. At an earlier hearing in February of this year the ATO acknowledged 'the majority of people in the Prescribed Payments System find it is a convenient way of paying their tax.' The Committee is of the view that the PPS is for many of these involved a PAYE system and this factor should be given recognition by the ATO.

5.4.4 In its previous report 'A Taxing Review' the Committee recommended that the ATO formulate strategic plans regarding improvement to the PPS and its extension to other industries.

5.4.5 The ATO is starting to look at what other areas the Prescribed Payments System can be extended to. (pg 114)

## 5.5 Case Selection

5.5.1 One area highlighted by Audit is 'the need for an effective means of case selection, which ensures that cases with the probability of returning the highest amount of uncollected tax are selected for priority investigation'.

5.5.2 Reference was then made by Audit to the SCORE system:

3.6.3. The SCORE system ranks the income tax returns of business and professional taxpayers by allocating scores for variations from industry

standards and from the previous year's performance. The returns which are allocated the highest scores are generally expected to be those with best audit potential (that is those in which the anticipated tax avoidance is the greatest). The system is accessed through a case profile program by the specification of selection criteria such as return type, industry code, score, component score, region and turnover, or by the nomination of individual file numbers.

5.5.3 Audit acknowledged that the SCORE system which began operating in April 1987 has redressed many of the failings of the previous systems. It provides a database of cases.

5.5.4 A feature of the SCORE system is that it provides access to all tax returns received and enables cases with a high level of expenses to be earmarked:

'what the SCORE system does is to pick out the returns with greater potential so that we do not have to look through the whole gamut of our returns to find a pool which we can refine to viable cases.' (pg 15)

## 5.6 Self Assessment

5.6.1 The introduction of self assessment from 1 July 1986 represented a fundamental change to the system of compliance with tax laws. As part of this system the ATO:

- . has expanded the scope of its general (i.e. field) audit program;



- . introduced a new program of desk audits, and
- . continued to increase the amount of information captured for computer based income matching processes. (Submission pg 2)

5.6.2 Under this system the emphasis is on auditing the taxpayer after the assessment has been issued.

5.6.3 In the first year of operation, revenue collections were \$1.2 billion in excess of budget estimates, of which voluntary compliance represented \$700 million.

## 5.7 Summary

5.7.1 The ATO must be ready to respond to changed circumstances and use the technology available to it.

5.7.2 There have been a number of initiatives undertaken by the ATO within the last few years some of which have been outlined in this Chapter and which will be monitored by the Committee and the Audit Office.

5.7.3 The Committee in general welcomes the initiatives and the emphasis on the top end of the market.

## CHAPTER 6

### OVERVIEW

#### 6.1 Overview

- 6.1.1 The aim of this report as outlined in Chapter 1 is twofold, first to assess the Audit report and secondly to examine the response of the auditee.
- 6.1.2 The Audit report has detailed the changes taking place within the ATO and provides valuable information on the initiatives within the ATO. In this respect it has made a useful assessment of the ATO taxpayer compliance strategy. It also supports the ATO decision to concentrate on the more productive sectors, i.e. the top end of the market.
- 6.1.3 The response of the ATO to the report was positive. The audit was conducted during a time of fundamental change in tax administration, and the inadequacies and deficiencies revealed at the time have been or are being addressed.
- 6.1.4 A special feature of the inquiry is the relationship between the AAO and the ATO.
- 6.1.5 According to AAO 'we have a good working relationship, we are able to discuss our recommendations in a quite free and open forum' (pg 48) and 'the end result is that we come up with an audit with much more useful recommendations.' (pg 48)

- 6.1.6 As has been noted earlier in the report events have overtaken this audit, yet it has been successful in that it identified areas which lead to an increase in tax revenue of \$3.3m. The ATO has suggested that the resources devoted to the audit might have been better employed. The Committee is not in a position to make a definite comment on this issue.
- 6.1.7 What the audit has achieved is to confirm the strategy being adopted within the ATO and to indicate areas for further investigation. Of the 54 recommendations in the report virtually all have been acted upon.
- 6.1.8 One result of the audit has been to reduce concentration on the unincorporated business sector and to focus the ATO audit activities on more productive areas. According to the ATO, 'the audit results show the higher the income the greater the potential for evasion.' (pg 89) The ATO also acknowledges that 'what we have to do is get smarter about which areas we should put resources into at any particular time.' (Transcript pg 114)
- 6.1.9 The audit was one of 13 of the ATO to have been undertaken in recent years. The audit has provided 'a spur' to the ATO. The changes that have been outlined earlier in this report indicate this.
- 6.1.10 Another feature of the report is that it identifies the requirement for the ATO to have available to it the appropriate technology or the tools of the time. In this regard a unique identifier will assist greatly. Audit considered it to be the highest priority.
- 6.1.11 Case selection featured prominently in the report and in this area the ATO has been able to lift its game. The introduction of the SCORE system is a welcome initiative.

6.1.12 The targeting of particular industries is another feature. It would appear that publicity given to targeting of an industry increases taxpayer compliance.

6.1.13 The final point is to draw attention to the recommendation made in earlier reports for a high integrity identification system. This proposal has the support of both the Audit Office and the Taxation Office. The introduction of such a system should assist in ensuring that taxpayers as well as those who should be taxpayers meet their obligations to each other.



STEPHEN MARTIN, MP  
CHAIRMAN

*Appendix I*

## List of Witnesses

| Witness                                                                                                                                                      | Date(s) of Appearance<br>before Committee at<br>Public Hearings |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------|
| Mr Gerald Anthony Barry,<br>Assistant Deputy Commissioner, Audit Group,<br>Australian Taxation Office,<br>Brisbane, Queensland                               | 23.6.88                                                         |
| Mr John Arthur Bowden,<br>Assistant Auditor-General,<br>Australian Audit Office,<br>Canberra, Australian Capital Territory                                   | 27.7.88                                                         |
| Mr Robert Charles Burr,<br>Deputy Commissioner,<br>Australian Taxation Office,<br>Hobart, Tasmania                                                           | 27.7.88                                                         |
| Mr Richard Francis Highfield,<br>Senior Assistant Commissioner, Audit Group,<br>Australian Taxation Office,<br>Canberra, Australian Capital Territory        | 23.6.88<br>27.7.88                                              |
| Mr Anthony Joseph McInerney,<br>Assistant Commissioner, Business and Primary Audit,<br>Australian Taxation Office,<br>Canberra, Australian Capital Territory | 23.6.88<br>27.7.88                                              |
| Mr William David Mulherin,<br>Deputy Commissioner,<br>Australian Taxation office,<br>Newcastle, New South Wales                                              | 27.7.88                                                         |
| Mr Gregory Malcolm Williams,<br>First Assistant Auditor-General,<br>Australian Audit Office,<br>Canberra, Australian Capital Territory                       | 27.7.88                                                         |

*Appendix II*

## Submissions Authorised for Publication

|                            | Date Received |
|----------------------------|---------------|
| Australian Audit Office    | 23.12.87      |
| Australian Taxation Office | 8.4.88        |