

## Review of evidence and Committee findings

### Duplication and overlap

#### Background

- 3.1 The issue of co-ordinating scrutiny of the Australian Taxation Office (ATO) has been raised before in committee proceedings. In November 2011, the Joint Committee of Public Accounts and Audit (JCPAA) finalised the report for its Ninth biannual hearing with the Commissioner of Taxation. One of the main themes of the hearing and report was external scrutiny and review. The Committee noted the importance of the scrutiny bodies, which comprised at that time the Auditor-General, the Inspector-General of Taxation, and the Commonwealth Ombudsman.<sup>1</sup>
- 3.2 At the hearing, the Acting Ombudsman raised the issue of coordinating ATO scrutiny, stating, 'with the plethora of players in the oversight space or the integrity agency space, there was some confusion and a need for greater clarity.'<sup>2</sup>
- 3.3 The understanding of the JCPAA was that the scrutineers did communicate their work programs to each other, 'but only to a limited extent.' The Committee suggested that the scrutineers further analyse how

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1 JCPAA, *Report 426: Ninth biannual hearing with the Commissioner of Taxation*, November 2011, p. 27.

2 Ms Alison Larkins, Acting Commonwealth Ombudsman, *Committee Hansard*, 23 September 2011, Canberra, p. 14.

they could better plan and improve information sharing.<sup>3</sup> The JCPAA recommended:

... that the external review agencies investigate and report on opportunities for more strategic planning and improved information sharing as they undertake their reviews to avoid duplication of their efforts and the Australian Taxation Office's resources.<sup>4</sup>

- 3.4 The scrutiny agencies provided a joint response to the recommendation. They stated that they had not identified 'any specific issues of duplicated review activity'. They also noted examples of their coordination, such as between the ANAO and Inspector-General in relation to their reviews of the ATO's management of small to medium enterprises. Another example was coordination between the Inspector-General and the Ombudsman in relation to the former's review of the ATO's Change Program.<sup>5</sup>
- 3.5 The scrutineers promised to 'meet collectively as part of their annual planning processes to share information and consider more broadly the overall ATO review activity.'<sup>6</sup> The joint response from the scrutiny agencies is included as Appendix E.
- 3.6 Despite this arrangement, the ATO claimed during the current inquiry that it was subject to duplication and overlap in scrutineer reports. The ATO's submission included a number of case studies, one of which is laid out in Table 3.1.
- 3.7 The ATO expressed concern that the reviews often focussed on single topics, leading to a fragmented approach, and that there was insufficient time to bed down improvements:

The reviews have tended to focus only on single aspects of dispute resolution ... This leads to a fractured approach to review and recommendations that do not consider the impact across the whole dispute resolution system, for both taxpayers and the ATO. The rapid succession of reviews (and often follow up reviews) on the

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3 JCPAA, *Report 426: Ninth biannual hearing with the Commissioner of Taxation*, November 2011, pp. 31-32.

4 JCPAA, *Report 426: Ninth biannual hearing with the Commissioner of Taxation*, November 2011, p. 32.

5 Auditor-General, Acting Ombudsman, and Inspector-General of Taxation, *Executive Minute on Joint Committee of Public Accounts and Audit, Report 426, Ninth biannual hearing with the Commissioner of Taxation*, May 2012, p. 2.

6 Auditor-General, Acting Ombudsman, and Inspector-General of Taxation, *Executive Minute on Joint Committee of Public Accounts and Audit, Report 426, Ninth biannual hearing with the Commissioner of Taxation*, May 2012, p. 1.

same subject matter (eg objections, settlement) often means there is little time for any recommendations or improvements to be bedded down. Different scrutineers are also approaching their topic from different perspectives resulting in recommendations not always being well aligned.<sup>7</sup>

Table 3.1 ATO example of overlap in scrutineer reports – director penalty notices

Year	Topic	Scrutineer
2010	Superannuation guarantee charge	Inspector-General of Taxation
2012	External debt collection agencies	Auditor-General
2013	Debt relief	Auditor-General
2014	Penalties	Inspector-General of Taxation
2014	Follow up of past reviews	Inspector-General of Taxation
2015	Compliance with the superannuation guarantee	Auditor-General
2015	Debt collection	Inspector-General of Taxation

Source ATO, *Submission 15, Appendix 4*.

3.8 The Committee received a number of submissions whereby stakeholders suggested that there was overlap in the reviews.<sup>8</sup> Greenwoods stated that, ‘there are indications that the external scrutiny is somewhat haphazard, spasmodic and misdirected in places’.<sup>9</sup> Chartered Accountants noted that the high volume of reviews meant that it occasionally had trouble in securing resources to contribute to an ATO review, or at least to the extent that it would have liked.<sup>10</sup>

## Analysis

3.9 During the inquiry, the scrutineers made two main points on this topic. Firstly, they stated that they held co-ordination meetings in line with their 2012 commitment to the JCPAA, which did result in changes to their work programs.<sup>11</sup> The Auditor-General stated:

... I reiterate the point that we and the inspector-general consult on our relevant programs. We have both formal and informal processes for doing it. There is an annual meeting between us to talk about it, and similarly, when we are developing our annual

7 ATO, *Submission 15, Appendix 5*.

8 For example, CPA Australia, *Submission 10*, p. 1; COSBOA, *Submission 21*, p. 1; KPMG, *Submission 25*, p. 3.

9 Greenwoods & Herbert Smith Freehills, *Submission 8*, p. 3.

10 CAANZ, *Submission 26*, p. 6.

11 Commonwealth Ombudsman, *Submission 16*, p. 4; IGT, *Submission 23*, p. 39.

program, we meet with the inspector-general's office, talk through the program and look at whether there are similar areas of coverage. That results quite regularly in changing the program to make sure that we are not doing the same thing. That happens formally when developing a program and also at the stage where we are putting together a scoping paper on what a particular audit will look like. We will go and talk through that to make sure, when you get into the detail, that everyone is aware of what is going on.

With respect to the building of our program, we develop a draft program. We give that to the JCPAA to consult with the parliament on the content of that program. It is also provided to all of the entities involved, including the ATO. We take their feedback on the program in developing it up.<sup>12</sup>

- 3.10 Consistent with this, the Inspector-General gave the example of Project Wickenby. The Inspector-General received a great deal of taxpayer feedback on this issue, but declined to investigate because it also involved agencies such as the Crime Commission and the Australian Federal Police. Both the ANAO and Commonwealth Ombudsman conducted reviews into it because their remit was across government and the Inspector-General's powers did not extend beyond the ATO.<sup>13</sup>
- 3.11 The Committee notes that some scrutineer reports have discussed how they co-ordinated with their colleagues. In 2011 both the ANAO and the Inspector-General completed reports into compliance for small and medium enterprises. Both reports cross-referenced each other and explained how they sub-divided the topic to avoid overlap.<sup>14</sup>
- 3.12 The second point that the scrutineers made was that conducting reviews on related topics did not automatically indicate duplication. This could be because some reports might only touch on a topic by way of necessity or context. Therefore, in relation to the ATO's list of seven reports that covered director penalty notices, the Inspector General responded that:

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12 Mr Grant Hehir, Auditor-General, *Committee Hansard*, 19 April 2016, Canberra, p. 5.

13 Mr Ali Noroozi, IGT, *Committee Hansard*, 19 April 2016, Canberra, p. 4.

14 ANAO, *The Management of Compliance in the Small to Medium Enterprises Market*, Report no. 16 2011-12, December 2011, p. 45; IGT, *Review into the ATO's compliance approaches to small and medium enterprises with annual turnovers between \$100 million and \$250 million and high wealth individuals*, December 2011, pp. 51, 66.

- the ANAO and Inspector-General's reports of 2015 examined director penalty notices in some depth (albeit for different purposes<sup>15</sup>)
  - the Inspector-General's report of 2010 only made a policy recommendation to government and probably did not involve an information request from the ATO
  - the remaining four reports only mentioned director penalty notices in passing or by way of context.<sup>16</sup>
- 3.13 The scrutineers also pointed out that they conduct their reviews from different perspectives. Therefore, reviews on similar headline topics can be substantially different in substance. In evidence, the ANAO commented that the Inspector-General's reviews were more from the taxpayers' perspective, whereas ANAO reviews focussed on risk, IT, and controls.<sup>17</sup> However, the ATO disputed this and argued that ANAO and Inspector-General reviews were similar, stating, 'They cover very much the same types of things in the same types of ways.'<sup>18</sup>
- 3.14 The Committee notes these comments. It is apparent that, if co-ordination and recognition of others' work is effective, then there will be minimal unnecessary duplication or overlap, and where it does occur the reasons will be clear. To investigate the effectiveness of co-ordination, the Committee examined three related reviews on tax debt, which was another example of overlap raised by the ATO.<sup>19</sup> The case study is on the next page. It shows that scrutineer reports generally demonstrate how their reports relate to each other, although not always.

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15 The ANAO report covered the topic in the context of the superannuation guarantee, whereas the Inspector-General's report covered it in the context of taxpayer solvency and whether they could pay their tax: ANAO, *Promoting Compliance with Superannuation Guarantee Obligations*, Report no. 39, June 2015, pp. 101-03; IGT, *Debt Collection*, July 2015, pp. 103-08.

16 IGT, *Submission 23.1*, pp. 19-20.

17 Mr Andrew Morris, ANAO, *Committee Hansard*, 19 April 2016, Canberra, p. 5.

18 Mr Andrew Mills, ATO, *Committee Hansard*, 16 March 2016, Canberra, p. 12.

19 ATO, *Submission 15*, Appendix 5.

### Case study – three tax debt reports

Between 2012 and 2015, ATO scrutineers released three reports into tax debt. Firstly, the ANAO released a report in June 2012 on how the ATO managed its use of external debt collection agencies (EDCAs). The ANAO then released a report on debt relief 12 months later. In the second report, the ANAO noted its previous reports on tax debt up to 2007, and then the 2012 report. The ANAO stated that debt relief had not been covered extensively in these previous reports.<sup>20</sup>

The 2013 ANAO report included: ATO engagement with debtors and guidance for its debt staff; assessing debt relief applications including the quality of decisions to remit interest; measuring the extent to which its debt relief strategies help taxpayers recover financially and meet their tax obligations; automated debt relief processes; and reporting of debt relief.

In July 2015, the Inspector-General of Taxation finalised a review into debt collection. The report had a chapter on external debt collection agencies and discussed the 2012 ANAO report. The Inspector-General's report also discussed debt payment assistance, which is a similar concept to debt relief. The Inspector-General's report did not discuss the 2013 ANAO report for this topic.<sup>21</sup>

On debt payment assistance, the Inspector-General's report covered: payment arrangements, including training for ATO staff; debt release for serious financial hardship; and remitting interest, including better engagement with taxpayers to encourage prompt payment.

There are three relationships between the reports:

- the 2013 ANAO report explained that it covered different ground than the 2012 ANAO report
- the Inspector-General's 2015 report referenced and took into account the 2012 ANAO report. This included deferring the examination of the security of taxpayer information held by EDCAs due to its recent review
- the Inspector-General's 2015 report did not mention the 2013 ANAO report, leaving the issue of co-ordination unresolved.

20 ANAO, *The Engagement of External Debt Collection Agencies*, Report no. 54 of 2011-12, June 2012; ANAO, *Management of Debt Relief Arrangements*, Report no. 52 of 2012-13, June 2013, p. 34.

21 IGT, *Debt Collection*, July 2015, p. 142.

## Committee comment

- 3.15 What struck the Committee during the inquiry is how far apart the ATO and scrutineers are on some of the issues. The question of duplication is one of them. The scrutineers believe they communicate effectively to minimise unnecessary duplication, yet the ATO and some stakeholders stated that it nonetheless occurs in some instances.
- 3.16 Overall, the Committee is of the view that the ATO has overstated the extent of duplication and that the extent of any duplication if it does occur is minimal.
- 3.17 To take an example, the ATO argued that seven reports examined director penalty notices, when four of the reports discussed the topic only as background. Such background context is necessary within scrutineer reports and is unlikely to have imposed significant burden upon the ATO in its development.
- 3.18 The Committee strongly supports the principle of discretion for scrutineers to select the reviews they think are the most valuable, within the confines of their legislation. Indeed, strong levels of independence are provided in their respective Acts and these are all necessary and appropriate to allow the scrutineers to perform the tasks expected of them by Parliament and government.
- 3.19 The Committee has also investigated the methods used by the scrutineers to discuss and develop their annual work plans and manage ad hoc issues, concluding that this process is sound. The process involves appropriate levels of consultation between the scrutineers themselves as well as extensive opportunities for consultation with the ATO.
- 3.20 The Committee therefore does not see the need for reform of the scrutineer's mandates or processes on the basis of perceived duplication.
- 3.21 However, there is potential for minor improvements to the transparency of the coordination process between scrutineers and to public explanations of the context and rationale for each review.
- 3.22 The Committee notes that the public information available about the coordination meetings is limited. The meetings are briefly mentioned in the Inspector-General's annual report, but not in the annual reports of the other two scrutineers. They are not specifically mentioned in the materials the scrutineers publish about their forward work programs, although they refer to consultations generally. The committee notes that there has been some examples of public coordination statements for standalone issues, such as in 2011 when the Inspector-General announced that he would not

investigate Project Wickenby because the ANAO and Ombudsman had a wider coverage of agencies.<sup>22</sup>

- 3.23 Without being prescriptive about how this might occur, the Committee suggests that the scrutineers consider ways of increasing the transparency of their co-ordination meetings and the fact that they work to avoid duplication in ATO scrutiny.

### Recommendation 1

- 3.24 **To increase transparency, the Committee recommends that the Auditor-General, Commonwealth Ombudsman, and Inspector-General of Taxation examine ways to increase the profile of their co-ordination activities – potentially through their websites, annual reports, and consultations undertaken for work programs.**
- 3.25 Consistent with this recommendation, the Committee also sees scope for the scrutineers to improve the way that they set the context for inquiries in their reports. The Committee notes that this is often done; however there is scope to ensure this is done for all reports and to provide additional explanation. It is also important that the scrutineers do this when they might believe that the lack of overlap is apparent, to avoid misunderstandings that may stem from a less intimate knowledge of the reports contents.
- 3.26 The Committee raised this issue with the scrutineers and the Auditor-General referred to a recent JCPAA report, which covered the topic of how reports explain the audit scope and approach. The Auditor-General stated that he would be prepared to look at what the ANAO could do to put its work into better context.<sup>23</sup>
- 3.27 The Committee thanks the Auditor-General for his readiness to consider this matter and makes the following recommendation to all scrutineers.

22 IGT, *Annual Report 2014-15*, October 2015, p. 11; IGT, 'Our work program' <<http://igt.gov.au/our-reviews/our-work-program/>> viewed 21 April 2016; IGT, '2011-2012 IGT Work program announced' <<http://igt.gov.au/news-and-media/igt-work-program-announced/>> viewed 21 April 2016.

23 Mr Grant Hehir, Auditor-General, *Committee Hansard*, 19 April 2016, Canberra, p. 10; JCPAA, *Report 454: Early Years Quality Fund*, February 2016, p. 71.

## Recommendation 2

- 3.28 **To increase transparency, the Committee recommends that the Auditor-General, Commonwealth Ombudsman, and Inspector-General of Taxation improve the explanation in their reports of why each review was conducted and how the review fits in with past and other current reviews.**

## Cost to government of scrutiny

### Background

- 3.29 In its submission, the ATO argued that it was required to divert significant resources to respond to the work of scrutineers:

The value to the community and return (or lack thereof) on investment in scrutiny is important and warrants the Committee's examination. The direct, indirect and foregone costs of scrutiny need to be weighed up. Regardless of the relative merits of reviews, significant ATO resources are being drawn away from other work and priorities and invested in the scrutiny process, all in a time of diminishing resources.<sup>24</sup>

- 3.30 The ATO also noted that there is a current drive across government to reduce red tape and inefficiency. In support of this, the ATO cited the National Commission of Audit in 2014 and Barbara Belcher's Independent Review of Whole-of-Government Internal Regulation in 2015.<sup>25</sup>
- 3.31 Chartered Accountants put a related view, namely that a large degree of public scrutiny could suggest an agency in crisis, when this was not the case.<sup>26</sup>
- 3.32 In 2013, a Capability Review of the ATO was conducted under the auspices of the Australian Public Service Commission. It argued that the ATO was 'fortunate' to be subject to considerable external scrutiny.<sup>27</sup> The Committee's interpretation is that it helps prevent emerging issues from becoming disruptive.

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24 ATO, *Submission 15*, p. 1.

25 ATO, *Submission 15*, p. 15.

26 CAANZ, *Submission 26*, p. 6.

27 APSC, *Capability Review: Australian Taxation Office*, May 2013, p. 13.

## Analysis

- 3.33 It would appear to the Committee that examining the costs of scrutiny makes the most sense if its benefits are also considered. This argument was also made by the Inspector-General.<sup>28</sup> Some stakeholders saw benefits in scrutiny through supporting community confidence in the tax system or as a form of investment.<sup>29</sup>
- 3.34 In evidence, the Inspector-General commented that external scrutiny also had benefits in terms of voluntary compliance. If confidence in the tax system drops, then levels of voluntary compliance may also fall, increasing ATO costs as it seeks to secure higher rates of involuntary compliance.<sup>30</sup>
- 3.35 The Office of the Inspector-General of Taxation further noted that effective external scrutiny of the ATO provides comfort to overseas investors. In effect, it is part of their risk management:

I also think that businesspeople often look at perceptions from their own local perspective. For example, if I am a US investor coming into what I think is really a First World country I am expecting similar sorts of checks and balances to those I am used to having at home. In the States they have a very complex system of scrutiny that has evolved over some period. We have some parallels with that, and they take comfort from that when they see that as external investors coming in.<sup>31</sup>

- 3.36 Assessing the costs and benefits of external scrutiny can be difficult because there is no clear counterfactual. Greenwoods noted that, ideally, the costs of external scrutiny should appear to be wasted as hopefully no strong findings are made:

And it is more than a little ironic that, in this area, the investment in promoting external scrutiny should ideally appear to be 'wasted' – the preferred outcome is obviously that the external scrutiny will reveal that nothing untoward is happening. In the absence of a 'smoking gun,' it is easy to be misled into thinking that the sunk investment in establishing mechanisms for external scrutiny was excessive and has simply added to the deadweight cost of the system, but that would be a short-sighted view. There is

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28 IGT, *Submission 23*, p. 6.

29 H&R Block, *Submission 6*, p. 2; Mark West, *Submission 14*, p. 1.

30 Mr Ali Noroozi, IGT, *Committee Hansard*, 19 April 2016, Canberra, p. 11. This point was also made by AFMA, *Submission 19*, p. 3.

31 Mr Andrew McLoughlin, Deputy IGT, *Committee Hansard*, 19 April 2016, Canberra, p. 12.

a fine judgment to make to determine just how much money should be invested in order to be confident that nothing significant remains to be discovered.<sup>32</sup>

3.37 Finally, the Committee received evidence that the ATO could itself improve how efficiently it engaged during reviews. The Inspector-General claimed that the ATO engaged in the following practices:

- a large number of staff attending meetings and discussions, of which only a small number participate
- a lack of engagement with the Inspector-General in relation to requests, resulting in excessive internal ATO processes to resolve issues
- the ATO undertaking its own internal reviews in parallel with the Inspector-General reviews
- the ATO justifying or contextualising the information it provides, when this is not necessary from the perspective of the Inspector-General
- the ATO allocating significant resources to defending strongly-held views during an inquiry.<sup>33</sup>

## Committee comment

3.38 The Committee believes that agencies should operate as efficiently as possible and the cost of scrutiny is an important issue. However, costs cannot be considered separately to benefits. Although the ATO's submission discussed costs, the Committee would have preferred it if the ATO provided some information that would support a cost/benefit judgement to be made. The ATO's submission unfortunately did not provide any substantive recognition of the benefits of scrutiny, whether to the broader tax system or to ATO processes. Furthermore, it did not provide substantive evidence on what the internal costs of scrutiny actually are.

3.39 The Committee is of the view that the cost of external scrutiny provides a good return on investment for Australia. This return flows directly to the ATO, and indirectly to Government, the Parliament, and Australian businesses and individuals. It also flows to foreign investors through increased confidence in Australian tax system administration. Scrutiny is an investment in the tax system, not a cost.

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32 Greenwoods & Herbert Smith Freehills, *Submission 8*, p. 2.

33 IGT, *Submission 23*, p. 40.

- 3.40 The Committee also comments that the costs of scrutiny need to be kept in perspective relative to the size of the ATO and its importance to the economy. The Australia's Future Tax System (AFTS) review noted that the resources available to the Inspector-General and the Ombudsman were 'not substantial',<sup>34</sup> and this situation has not changed.
- 3.41 The Inspector-General has commented that the ATO could take some action to reduce its inquiry costs. The Committee also notes that the ATO can decline to implement some recommendations due to cost, and has occasionally done so in the past, or at least stated that implementation will depend on funding.<sup>35</sup> Finally, the Committee believes some of the issues around cost may be related to communication during reviews. This topic is covered later in the report.

## Differential regulation (earned autonomy)

### Background

- 3.42 The concept of differential regulation (previously referred to as earned autonomy) arose in the Commonwealth context during the Commonwealth Financial Accountability Review. The position paper produced by the then Department of Finance and Deregulation (Finance) in 2012 noted that the accountability framework at the time used a one-size-fits-all approach in placing obligations on agencies. It recommended a more proportionate system based on an agencies' risk. The document sought to 'improve accountability and performance through managing risk not through increasing control'.<sup>36</sup>
- 3.43 Financial management in agencies is now governed by the *Public Governance, Performance and Accountability Act 2013*. In its current guidance on differential regulation, Finance notes that the Act allows the Finance Minister to apply some of Act's requirements differentially. Further, entity heads have greater autonomy and are required to take into account entity risk in establishing their internal controls.<sup>37</sup> The Act governs the use and

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34 AFTS, *Report to the Treasurer, Part Two, Detailed Analysis, volume 2 of 2*, December 2009, p. 663.

35 IGT, *Review into the Australian Taxation Office's administration of penalties*, February 2014, p. 60; IGT, *Review into improving the self-assessment system*, August 2012, p. 86.

36 Department of Finance and Deregulation, *Sharpening the Focus: A Framework for Improving Commonwealth Performance*, November 2012, pp. 23-25.

37 Department of Finance, 'Public Management Reform Agenda: Differential Regulation' <<http://www.pmra.finance.gov.au/differential-regulation/>> viewed 23 February 2016.

management of public resources, performance reporting, financial reporting, and appropriations.

3.44 Differential regulation is still an emerging concept in Australia, but Finance has provided some factors that can be taken into account. These are:

- strong management capability, including culture, output, systems and processes
- strong internal review processes to respond to issues early
- using good management practice to achieve the entity's purposes
- the entity's risks
- how the government prefers to receive information and its views on transforming the public service
- appropriate levels of accountability to stakeholders such as Ministers, the Parliament and the public.<sup>38</sup>

3.45 In its submission, the ATO acknowledged that differential regulation was not directly relevant to an agency's external scrutiny. However, it suggested that the concept could be extended to the scrutineers and that they could take into account the ATO's risk management and performance:

Whilst the benefits of an earned autonomy/differential approach, in terms of application to the Commonwealth Resource Management Framework, are yet to be realised, there could be an opportunity to extend this concept to the level of inquiry by our external scrutineers.

This would mean in areas that the ATO consistently demonstrates good risk management and high standards of performance, our level of scrutiny could be adjusted accordingly so that reviews could be redirected to higher risk areas and away from lower risks. This would mean that reviews are proportionate to risk and performance and more streamlined (and reduced).

The ATO could rely on the mechanisms we already have, to effectively monitor and assess our risks and performance and

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38 Department of Finance, 'Public Management Reform Agenda: Differential Regulation' <<http://www.pmra.finance.gov.au/differential-regulation/>> viewed 23 February 2016.

drive activity into areas that are worth investigating by our external scrutineers.<sup>39</sup>

- 3.46 The SMSF Association and COSBOA took a similar view, arguing that the ATO was subject to excessive scrutiny and that it should be streamlined.<sup>40</sup>
- 3.47 Some information is available about the ATO's internal governance. The 2013 Capability Review acknowledged that the ATO had invested heavily in its governance framework. However, processes needed to be streamlined. Internal committees were often ineffective because they did not have authority to make decisions. Internal guidance was 'elaborate and formulaic', rather than useful. The governance mechanisms, such as risk management, planning, performance measurement and reporting were yet to be fully integrated.<sup>41</sup>
- 3.48 In April 2015, the ATO published its final implementation update on the Capability Review. The reported actions are consistent with the Review's recommendations and were co-designed with the Australia and New Zealand School of Government Institute for Governance.<sup>42</sup>
- 3.49 However, the Committee is not aware of any external, independent review of the ATO's governance since 2013. In its submission the ANAO stated that its performance audit reports indicated there was scope for the ATO to become more performance oriented:
- These reports have found that the ATO has relatively sound administrative processes, although with an emphasis on risk-based compliance arrangements rather than a performance-based approach focused on outcomes as well as outputs.<sup>43</sup>
- 3.50 The ANAO also stated that they apply concepts similar to differential regulation – a risk based approach – in selecting audit topics. Agencies that have demonstrated sound administration in previous years will generally have fewer performance audits.<sup>44</sup>

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39 ATO, *Submission 15*, p. 17.

40 SMSF Association, *Submission 18*, p. 1; COSBOA, *Submission 21*, p. 1.

41 APSC, *Capability Review: Australian Taxation Office*, May 2013, p. 13.

42 ATO, *ATO capability action plan: Final report – April 2015*, April 2015, p. 9.

43 ANAO, *Submission 17*, p. 4.

44 ANAO, *Submission 17*, p. 5.

## Analysis

- 3.51 In evidence, the Auditor-General made a number of criticisms of extending the principle of differential regulation to how the scrutineers examine the ATO:
- the ANAO, in particular, is an officer of the Parliament, whereas differential regulation refers more to ‘the extent to which executive government puts different regulatory frameworks on its entities’
  - scrutineers’ independence will be compromised if a third party is deciding whether the ATO has earned some autonomy
  - the size of the ATO means that scrutineers will always have an interest in its operations.<sup>45</sup>
- 3.52 The Auditor-General specifically made the point that the external scrutineers are not regulators.<sup>46</sup> To the Committee, this confirms that the ATO is under no obligation to act on scrutineer recommendations.
- 3.53 A majority of stakeholder submissions argued that current levels of scrutiny of the ATO should be maintained or perhaps increased, especially in relation to the role of the Inspector-General. This was sometimes put in terms of the ATO’s powers, the importance of its role, and sometimes supported on the basis that the Commissioner’s reinvention project was still a ‘work-in-progress’. It was also put in the context of uncertainty caused by changing tax laws.<sup>47</sup> H&R Block stated:

Broadly, the ‘earned autonomy’ principle is based on the concept that high performing organisations which demonstrate positive outcomes are rewarded with less rigorous oversight. Whilst recognising that such a concept may be appropriate in some government agencies, we are not convinced that the agency which manages the whole federal tax system and therefore plays a key role in the lives of every Australian, should be one of them.

Certainly, we do not believe that the overwhelming bulk of taxpayers would believe it to be in their interests for the ATO to be subject to less rigorous oversight. In an organisation the size of the ATO and with the legal powers of the ATO, many would see such

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45 Mr Grant Hehir, Auditor-General, *Committee Hansard*, 19 April 2016, Canberra, pp. 12-13.

46 Mr Grant Hehir, Auditor-General, *Committee Hansard*, 19 April 2016, Canberra, p. 12.

47 For example, Independent Contractors Australia, *Submission 3*, p. 2; Graeme Halperin, *Submission 5*, p. 1; Taxpayers Australia, *Submission 13*, p. 2; Chris Wallis, *Submission 28*, p. 4; Law Council of Australia, *Submission 9*, p. 2.

a path as highly inappropriate and an abdication of the requirement to maintain accountability to taxpayers.<sup>48</sup>

- 3.54 The Australian Financial Markets Association (AFMA) more broadly considered the general relationship between internal controls and external scrutiny. It argued that internal and external controls should be regarded as complements, rather than substitutes. If 'External scrutiny provides an incentive to improve internal risk management,' then removing external scrutiny may result in internal controls being misdirected.<sup>49</sup>

### Committee comment

- 3.55 The Committee acknowledges that the ATO is a well-run organisation and has acted upon many aspects of its 2013 Capability Review. The Committee also accepts that the *Public Governance, Performance and Accountability Act 2013 (PGPA Act)* provides a timely opportunity for agencies to consider risk in a more balanced way.
- 3.56 However, the operation of differential regulation is still under development and the *PGPA Act* deals with internal government regulation rather than external scrutiny. The *PGPA Act* primarily applies to financial management and performance reporting, and also deals with the relationship between the Finance Minister and accountable authorities (governing bodies and agency CEOs).
- 3.57 The term 'differential regulation' is technically not applicable to external scrutiny, as the scrutineers are not regulators. Differential scrutiny may however be an applicable concept.
- 3.58 Indeed, differential scrutiny is already in practice, although the term 'risk based approach' is more commonly used. All scrutineers take the ATO's risks into account when designing their forward work programs and specifying their individual audit details. Their assessments of risk are informed from a combination of sources, including: an analysis of the ATO's performance; stakeholder feedback (including feedback from the Parliament); and knowledge of the ATO's internal systems and processes.
- 3.59 The Committee notes the comments of stakeholders that the ATO's size and powers argue against any reduction in external scrutiny. The Auditor-General made a similar point. Stakeholders also receive a great deal of comfort from knowing that the ATO is subject to external scrutiny. The Committee finds these arguments very persuasive.
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48 H&R Block, *Submission 6*, p. 3.

49 AFMA, *Submission 19*, p. 3.

- 3.60 The Committee sees no compelling case for change in the way the ATO is examined from a differential scrutiny perspective.

## Specific issues

### Communication between the ATO and Inspector-General

#### Background

- 3.61 An important part of external scrutiny is that the scrutineer and agency engage in a full and frank exchange of views before, during and after a review. This allows informed decisions about which reviews to commence, allows expectations to be realistic, enables the review to be conducted efficiently, and maximises its effectiveness.
- 3.62 However, evidence during the inquiry indicated that both the ATO and the Inspector-General considered that communication during reviews could be considerably improved.
- 3.63 On the part of the ATO, they indicated to the Committee that they were unclear about how the Inspector-General selected review topics because they were not involved in the process whereby the Inspector-General receives stakeholder feedback:
- ... the processes that led to the Inspector-General deciding to inquire into something are not transparent to us ... The Inspector-General, quite appropriately, has his or her own powers to decide where to inquire into things, and they receive information, advice, complaints, feedback from people. We are not always privy to the information that has caused them to inquire into particular areas ... That is not a process that we are necessarily involved in ...<sup>50</sup>
- 3.64 The ATO claimed that the Inspector-General did not always take on board their comments on draft reports.<sup>51</sup> However, the ATO admitted that they then accepted recommendations that they did not support on the basis that 'there has been an expectation that we would agree to a great majority.'<sup>52</sup>

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50 Mr Geoff Leeper, ATO, *Committee Hansard*, 16 March 2016, Canberra, pp. 10-11.

51 Mr Andrew Mills, ATO, *Committee Hansard*, 16 March 2016, Canberra, p. 16.

52 Mr Geoff Leeper, ATO, *Committee Hansard*, 16 March 2016, Canberra, p. 14.

- 3.65 Overall, the ATO preferred ANAO scrutiny due to greater communication:

With great respect to the Inspector-General, we would say that the ANAO scrutiny is much more effective because there is more dialogue and two-way conversation. We have not had that lived experience in recent times with the Inspector-General ...<sup>53</sup>

- 3.66 In evidence, the Auditor-General confirmed that he had a positive relationship with the ATO, stating 'Our relationship with the tax office is strong.'<sup>54</sup>

- 3.67 On the part of the Inspector-General, his submissions outlined examples where he worked with the ATO in developing his work program and indeed amended the program based on ATO feedback:

... as a result of such consultations, the IGT has previously taken on board suggestions by the ATO to review certain areas of concern, as was the case with the IGT review into Private Binding Rulings as well as the ADR Review ... or not conduct a review where the ATO had advised that it was undertaking its own internal review and improvements.<sup>55</sup>

- 3.68 The Inspector-General also raised examples where the ATO could improve its communication during reviews.<sup>56</sup> These are the five dot points listed above in the discussion of cost to government and they include the ATO vigorously defending strongly held views and undertaking its own parallel reviews during an Inspector-General review.

- 3.69 Stakeholders usually did not comment on review communication. The exception was Chartered Accountants, who recommended that the Committee cover the issue in the inquiry.<sup>57</sup>

## Analysis

- 3.70 The Inspector-General provided the Committee with detail on how he constructs his work program. This material was originally provided to the JCPAA in December 2012 and published by that Committee. Broadly, the Inspector-General holds an open, advertised consultation to develop the program. Consulted parties included:
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53 Mr Geoff Leeper, ATO, *Committee Hansard*, 16 March 2016, Canberra, p. 16.

54 Mr Grant Hehir, Auditor-General, *Committee Hansard*, 19 April 2016, Canberra, p. 2.

55 IGT, *Submission 23*, p. 39.

56 IGT, *Submission 23*, p. 40.

57 CAANZ, *Submission 26*, p. 8.

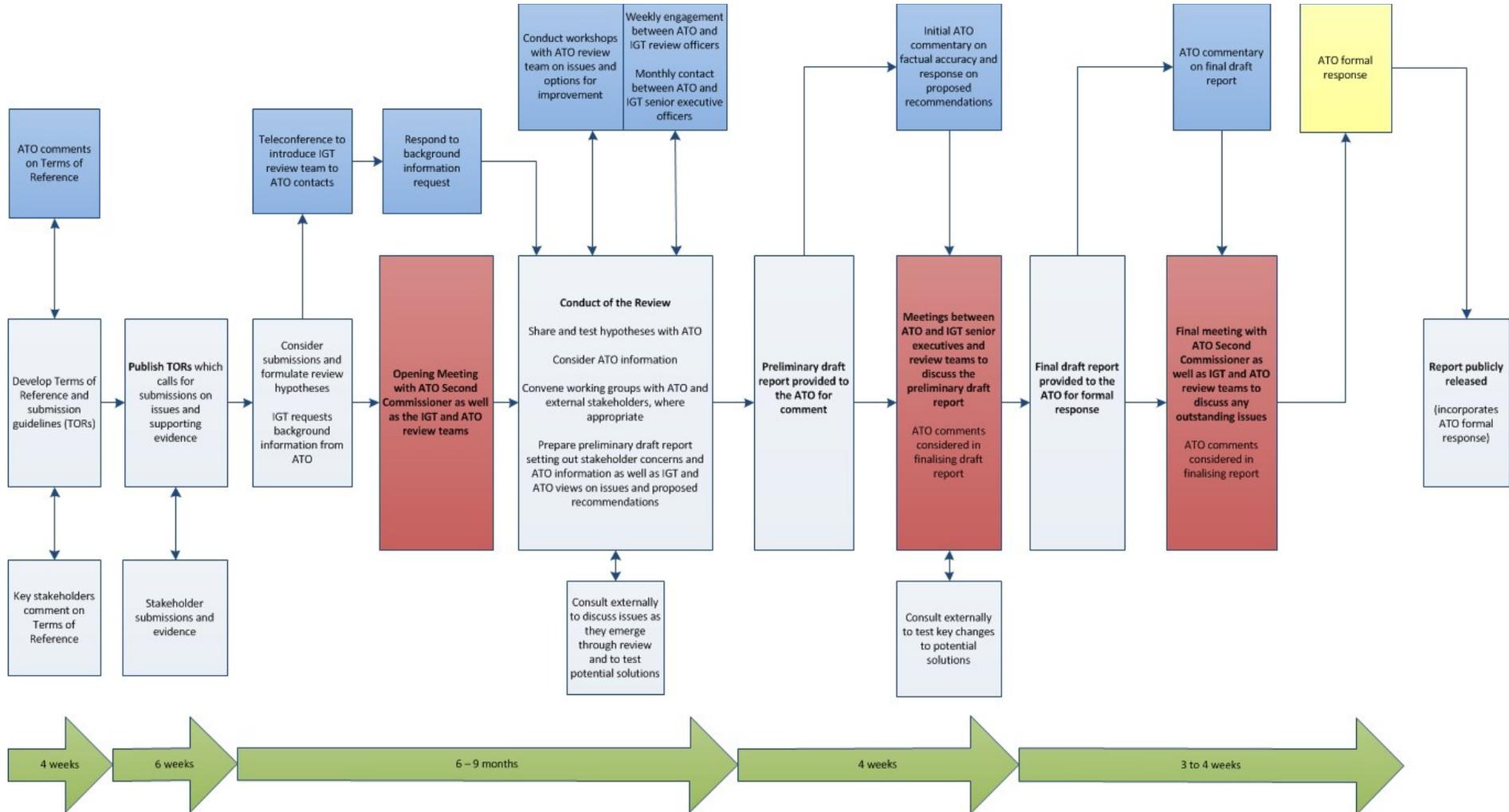
- the ATO
  - the Auditor-General and Ombudsman
  - professional bodies, taxpayers, law and accounting firms, and industry associations
  - the JCPAA
  - the Assistant Treasurer and Treasury.<sup>58</sup>
- 3.71 Specifically regarding consultations with the ATO in development of the work program, the Inspector-General stated that:
- prior to the formal public announcement of the work program, a final draft version of the document is presented to the ATO senior executives...
  - at these meetings, the IGT provides some insight to the ATO senior executives with a snapshot of the issues which have been brought to the IGT's attention and to seek their direct feedback on topic areas for review.<sup>59</sup>
- 3.72 The Inspector-General also provided the Committee with a timeline of consultations with the ATO during a review. This timeline is on the next page. The pattern for ATO consultations throughout the course of a review are:
- two meetings during planning – including allowing the ATO to comment on draft Terms of Reference
  - ad hoc workshops during the review to discuss issues
  - weekly meetings between ATO contacts and IGT review officers
  - monthly meetings between the ATO and senior IGT staff
  - three opportunities to comment on the report in its various stages.

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58 IGT, *Submission 23.1*, pp. 39-40.

59 IGT, *Submission 23.1*, pp 14-15.

Figure 3.1 External engagement during reviews by the Inspector-General of Taxation



Source IGT, Submission 23.2, p. 45.

3.73 At the hearing, the Office of the IGT expressed a readiness to work further with the ATO on communication. They suggested that there is an important history to ATO scrutiny that informs current arrangements:

I think there is benefit in having greater communication with the ATO senior management around some of the scrutineering issues, because I think there is a degree of education that will be helpful. I am not trying to talk down; it is just that I think there is a history associated with the agencies, the work that has been done and why some of it is where it is that may not be obvious at first instance. I think improved communication around those kinds of issues would be very important.<sup>60</sup>

3.74 Further, in their submission the Inspector-General stated that better communication could better streamline reviews, and that the agencies are looking to refresh a protocol guiding the conduct of reviews:

The IGT believes that through better project management, commitment to engage and openly share information and views, the ATO and IGT could better streamline the review process to reduce the risk of duplication and inefficiencies, thereby minimising the impact on costs and resources. To this end, and given the recent changes to the IGT Act 2003 and its core functions, both agencies are looking to refresh the IGT-ATO Protocol that had previously guided the conduct of systemic reviews.<sup>61</sup>

### Committee comment

3.75 The Committee is concerned about the state of communication between the Inspector-General and the ATO. Despite ATO evidence that was less dialogue and two way communication than in the case of ANAO reviews, evidence provided by the Inspector-General indicated that there is a large number of opportunities for communication both before and during reviews. This suggests that it is not the frequency, but perhaps the quality of communication and actions stemming from it that are the issues.

3.76 Communication between the Inspector-General and the ATO needs to improve. If communication over the past few years had been better, then this inquiry would probably have not been necessary. The Committee expects that better communication would also reduce ATO costs during

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60 Mr Andrew McLoughlin, Deputy IGT, *Committee Hansard*, 19 April 2016, Canberra, pp. 13-14.

61 IGT, *Submission 23.1*, pp. 41.

inquiries. If ATO costs dropped, stakeholders see an opportunity for the extra resources to be allocated to better stakeholder engagement.<sup>62</sup>

- 3.77 The Office of the Inspector-General expressed readiness to communicate more with the ATO. The Committee anticipates that the ATO is of a similar view. The Committee therefore recommends that the two parties take this opportunity to redouble their efforts to communicate better. In this regard, the Committee also encourages the agencies to finalise refreshment of their Protocol for conducting systematic reviews.

### Recommendation 3

- 3.78 **The Committee recommends that the Australian Taxation Office and the Inspector-General of Taxation redouble their efforts to improve communication before, during and after reviews.**

## The position and role of the Inspector-General of Taxation

### Background

- 3.79 A majority of submissions supported the position of the Inspector-General. H&R Block referred to that officer's 'highly regarded work'. The Institute of Public Affairs stated that its establishment was 'a fine reform.' Taxpayers Australia advised that its members have commended the performance of the Inspector-General. The Tax Institute, Institute of Public Affairs, and the Corporate Tax Association noted that the Inspector-General's work has led to improvements in tax administration.<sup>63</sup>
- 3.80 The Committee also received suggestions from stakeholders that the Inspector-General's role should be widened, either through increased resources or increased powers.<sup>64</sup>
- 3.81 Some submissions preferred a smaller role for the Inspector-General. The ATO omitted the Inspector-General from its preferred scrutiny framework. CPA Australia suggested that the Inspector-General's power to initiate systemic reviews could be discontinued. COSBOA stated that

62 SMSF Association, *Submission 18*, p. 1.

63 The Tax Institute, *Submission 2*, p. 2; H&R Block, *Submission 6*, p. 2; Institute of Public Affairs, *Submission 11*, p. 5; Taxpayers Australia, *Submission 13*, p. 2; Institute of Public Accountants, *Submission 24*, p. 4; CTA, *Submission 27*, p. 4.

64 Group of 100, *Submission 4*, p. 3; Law Council of Australia, *Submission 9*, p. 2; Mark West, *Submission 14*, p. 2; Chris Wallis, *Submission 28*, p. 5.

the role of the Inspector-General could be reconsidered, given that ‘some of the language from the IGT over the years has been over the top in its criticism of the ATO’. COSBOA also noted there was a risk that the Inspector-General, as a single agency scrutineer, might ‘end up justifying its existence rather than delivering an outcome’.<sup>65</sup>

- 3.82 Similarly, the Commonwealth Ombudsman expressed concern about creating an oversight body that covered a small number of agencies. One of the risks was that the scrutineer would not be able to take the middle ground and either be captured by the agency or become antagonistic towards it:

In my view, there is significant risk in creating an oversight body with responsibility for only one or two agencies. Such arrangements result either in a dysfunctional and antagonistic relationship between the oversight body and the agency, or in the oversight body being captured by the agency.

That relationship problem can, in my opinion, develop from the suggestion that a single agency complaint handler should have on its staff specialists in the business of the agency. This can lead to the complaint handler second guessing the agency’s decisions, which should not be its role.<sup>66</sup>

- 3.83 Another of the risks presented by the Ombudsman above is that specialist expertise for a scrutineer can result in the scrutineer ‘second guessing’ the agency’s decisions. However, two stakeholders were of the view that the Inspector-General’s specialist expertise was beneficial.<sup>67</sup>

- 3.84 The Committee received a range of suggestions on how the Inspector-General and the other scrutineers could be more effective. These included:

- reviewing current arrangements, in some cases with a view to reducing the number of external scrutineers<sup>68</sup>
- better communication and coordination among scrutineers<sup>69</sup>
- more forward looking reviews by the Inspector-General, in some cases focussing on emerging complaints and trends<sup>70</sup>

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65 CPA Australia, *Submission 10*, p. 3; ATO, *Submission 15*, p. 4; COSBOA, *Submission 21*, p. 4.

66 Commonwealth Ombudsman, *Submission 16*, p. 3.

67 Ernst & Young, *Submission 7*, p. 8; AFMA, *Submission 19*, p. 2.

68 The Tax Institute, *Submission 2*, p. 3; Greenwoods & Herbert Smith Freehills, *Submission 8*, p. 4; COSBOA, *Submission 21*, p. 2.

69 Law Council of Australia, *Submission 9*, p. 7; CTA, *Submission 27*, p. 2.

- the ATO sharing more of its risk information with scrutineers to reduce the need for a review to be conducted<sup>71</sup>
- caps on reviews<sup>72</sup>
- minimum time periods before revisiting a topic<sup>73</sup>
- fewer reviews with broader subjects<sup>74</sup>
- clarifying the roles of scrutineers, including a 'lead agency' system.<sup>75</sup>

## Analysis

- 3.85 The Committee would like to say up front that it believes that the office of Inspector-General should continue. This office has proven its worth through quality reviews that have improved the ATO's operations and the position of taxpayers, especially given its small size relative to the ATO. Further, it has strong support among almost all stakeholders. The Committee puts this down to the fact that the Inspector-General has built strong relationships with taxpayers and tax practitioners.
- 3.86 The Committee notes that other scrutineers do not work this way. However, the complexity of the tax system, and the substantial resources and powers of the ATO, mean that a role for the Inspector-General, or at least a scrutineer that pledges to reach out to taxpayers, should continue for the foreseeable future.
- 3.87 CPA Australia noted that the new role for the Inspector-General was still bedding down, and the Inspector-General did not have the opportunity to deliver on the potential efficiencies from taking over the complaints function for tax administration.<sup>76</sup> This suggests to the Committee that no changes are warranted to his Act and the Committee is happy to proceed on this basis.
- 3.88 The Committee appreciates the input that stakeholders and the ATO provided in terms of improvements that could be made to how reviews are selected and conducted. Some of the suggestions, however, such as

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70 IGT, *Submission 23*, p. 33; Institute of Public Accountants, *Submission 24*, p. 4; KPMG, *Submission 25*, p. 2; Mr Geoff Leeper, ATO, *Committee Hansard*, 16 March 2016, Canberra, p. 2.

71 CAANZ, *Submission 26*, p. 7.

72 CAANZ, *Submission 26*, p. 8.

73 ATO, *Submission 15*, p. 15.

74 ATO, *Submission 15*, p. 15; KPMG, *Submission 25*, p. 7.

75 CTA, *Submission 27*, p. 2; Mr Geoff Leeper, ATO, *Committee Hansard*, 16 March 2016, Canberra, p. 2.

76 CPA Australia, *Submission 10*, p. 2.

caps on reviews and minimum time periods before revisiting a topic, would limit the scrutineers' discretion. The Committee does not support these suggestions and believes it is important that the scrutineers retain flexibility to allow them to prioritise their work and that it is consistent with their independence.

### Committee comment

- 3.89 One of the features of the Inspector-General's expanded role is that tax complaints and the means to systematically review them now sit within the same agency. Although the Inspector-General has always extensively consulted on his work program, there is the opportunity to conduct shorter, more timely reviews based on complaints data. Not only did some stakeholders suggest this, but both the ATO and Inspector-General did as well. Based on this consensus, the Committee is happy to present it as a recommendation.

### Recommendation 4

- 3.90 **The Inspector-General of Taxation examine opportunities to conduct targeted reviews based on complaints and emerging issues in tax administration, and work with the Australian Taxation Office to develop a mutually efficient system for such reviews.**
- 3.91 The Committee notes the structural issues raised by the Ombudsman and the fact that a specific scrutineer may have difficulty taking the middle path with the agencies it is responsible for. The Committee acknowledges that this is a risk which must be managed.
- 3.92 One way of managing this risk is to build on current processes, in particular the biannual hearings that this Committee holds with the Commissioner of Taxation, and which the Inspector-General attends. These hearings can be expanded to also scrutinise the Inspector-General at minimum additional cost to all parties. Alternatively, the Committee may choose to conduct a separate dedicated regular inquiry into the annual report of the Inspector-General. Such an inquiry would provide a forum for the Inspector-General to raise matters of significance to his office directly with parliamentarians, and would also allow additional scrutiny of the Inspector-General's efficiency, effectiveness and impartiality.

## Recommendation 5

- 3.93 **The Committee recommends that the Standing Committee on Tax and Revenue of the next Parliament consider expanding its biannual inquiries into the Australian Taxation Office to include scrutiny of the Inspector-General of Taxation, or alternatively to conduct a separate dedicated regular inquiry into the annual report of the Inspector-General.**

## The role of this Committee

### Background

- 3.94 Taxation and tax administration have often been a focus of Parliamentary scrutiny. A landmark inquiry was 1993's *An Assessment of Tax* conducted by the then Joint Committee of Public Accounts (JCPA). Shortly thereafter followed an inquiry in 1995 to discuss progress of the Tax Law Improvement Project, which was a product of the 1993 inquiry.
- 3.95 In 2005 the JCPAA resolved to conduct a long term inquiry into administration of the tax system, culminating in 2008's report *Tax Administration*. During the inquiry, the Committee met with the Commissioner of Taxation biannually. After the 2008 report, the Committee continued to hold biannual hearings with the Commissioner. The hearings were then expanded to include other witnesses and held on an annual basis from 2012.
- 3.96 This Committee was created in late 2013 and, after corresponding with the JCPAA to avoid duplication, has held biannual hearings with the ATO, commencing in February 2014.
- 3.97 This inquiry has allowed the Committee to obtain some feedback on its work. At the biannual hearing in February this year, the Commissioner of Taxation stated that this Committee could play a role in constructively scrutinising the ATO:

This committee is relatively new and has been added to all the existing levels of scrutiny that we at the ATO already have. However, I do believe that this committee can play an important role in the right scrutiny of the ATO and help create a modern tax office that is a leading administration envied by other countries.

3.98 Some submissions were similarly supportive of the Committee.<sup>77</sup> Others suggested that the Committee could do more to follow up scrutineer reports, similar to the recommendations in the Australia's Future Tax System Review.<sup>78</sup> CPA Australia suggested that the biannual hearings with the Commissioner of Taxation could change to annual hearings or be discontinued.<sup>79</sup> There were also suggestions that there was scope for better organisation and clarity around the work of parliamentary committees.<sup>80</sup>

### Committee comment

3.99 The Committee appreciates the feedback from stakeholders and the ATO. The strength of committee reports leverages off the expertise that agencies and stakeholders put on the public record. The Committee sees an opportunity to use this feedback to strengthen its relationship with the community of tax practice and to improve future hearings with the Commissioner of Taxation.

3.100 The Committee also acknowledges the value that parliamentary committees can generate from following up scrutineer reports. This has been a long standing practice for the JCPAA in relation to the Auditor-General's work. Indeed, one of this Committee's inquiries this Parliament was into an Auditor-General's report on the Tax Expenditures Statement. The Committee is open to conducting further inquiries of this nature and looks forward to ongoing dialogue with the scrutineers about their work.

3.101 The Committee is also conscious of the costs it can place on stakeholders through its inquiries, in this case on the ATO. In a similar way to other scrutineers, the Committee attempts to apply a risk based approach in deciding where to focus its lines of inquiry, with a view to producing meaningful outcomes for the agencies involved and for broader stakeholders. The Committee notes in particular the suggestions by Chartered Accountants that the Committee facilitate greater input into and prior notification of the topics for discussion in regular ATO scrutiny hearings. The Committee will consider implementation such suggestions in future hearings.

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77 The Tax Institute, *Submission 2*, p. 4; COSBOA, *Submission 21*, p. 5; Rule of Law Institute, *Submission 22*, p. 2.

78 Ernst & Young, *Submission 7*, p. 8; Law Council of Australia, *Submission 9*, p. 4; AFMA, *Submission 19*, p. 2.

79 CPA Australia, *Submission 10*, p. 2.

80 CAANZ, *Submission 26*, p. 9; CTA, *Submission 27*, p. 3.

## A board for the ATO

### Background

- 3.102 The issue of a board for the ATO was not specifically covered in the inquiry's terms of reference. However, it is relevant to the inquiry because some stakeholders see a board (or absence thereof) as a potential part of the ATO's accountability framework, albeit internally, rather than externally.
- 3.103 Three types of board have been discussed over time for the ATO:
- an advisory board, which is not responsible for an organisation's operations, but can provide advice to senior management on issues such as information technology, strategy and culture
  - a management board, similar to that found in companies, that is responsible for the management of the agency, although in revenue agencies it is typically not responsible for decisions made about individual taxpayers
  - a policy board, that provides advice to key parties (ministers, departments of state and the revenue agency) on tax policy. The Board of Taxation was established in 2000 for this task.
- 3.104 A number of submissions discussed whether the ATO should have a board. Ernst & Young and AFMA supported an advisory board, consistent with recommendation 115 of the AFTS Review. The Institute of Public Affairs and Taxpayers Australia supported a management board that would have some responsibility for the ATO's operations.<sup>81</sup>
- 3.105 In the past, the Inspector-General of Taxation has supported 'a management board (such as those of an advisory or supervisory nature)'.<sup>82</sup> In evidence, the Inspector-General commented that a board would be especially useful for long term planning:

At the moment you have the commissioner and then there are second commissioners and really most things are at the discretion of the commissioner. Whereas, ASIC and APRA have boards. The revenue agencies in the US, Canada and the UK – countries with which we compare ourselves – all have boards. Those boards do

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81 Ernst & Young, *Submission 7*, p. 10; Institute of Public Affairs, *Submission 11*, p. 6; Taxpayers Australia, *Submission 13*, p. 3; AFMA, *Submission 19*, p. 2.

82 Inspector-General of Taxation, *Tax Forum – next steps for Australia: A submission to the Tax Forum*, September 2011, p. 1.

not get involved in what scrutineers do; they are about long-term planning. For example, they might look at where they might want to be in terms of IT in 10 years' time and then they would have a plan for getting there.

... you would have your commissioner and your second commissioner but, in addition to that, you might have a finance person, a human resources person and an IT person external to the ATO who would also provide further insight into how you manage such a large organisation.<sup>83</sup>

- 3.106 The Law Council of Australia did not express an opinion about a board type, but suggested that the creation of a board would not be a reason to reduce the external scrutiny of the ATO.<sup>84</sup>
- 3.107 The preferred governance structure of the ATO is usually discussed in tax reviews. In 1993, the JCPA (the precursor to the JCPAA) issued a comprehensive report on the tax system. The Committee came to the view that there was an 'accountability gap' in the Commissioner's exercise of tax powers because the Commissioner cannot be instructed in how to exercise them and is less accountable to the Parliament than a minister. The Committee recommended that the relevant minister be given the power to issue general directions to the Commissioner, and that they be tabled in the Parliament.<sup>85</sup>
- 3.108 The Committee also noted the two main consultation committees that the ATO had established from the early 1980s to open up the tax system. These were the National Taxation Liaison Group and the Commissioner's Advisory Panel. The former focussed on tax practitioners (and still does) and the latter was more broadly based. Among its recommendations, the Committee suggested that the role of the advisory committees be formalised and strengthened.<sup>86</sup>
- 3.109 The idea of a taxation board was raised in the Review of Business Taxation in 1999. This Review considered two options: a policy board and a management board. The Review rejected a management board because it would interfere with the clarity of responsibility between a statutory authority and its minister. It took the view that the opportunity to allow business involvement in developing tax policy would provide greater certainty and less possibility for conflict in the later application of those

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83 Mr Ali Noroozi, IGT, *Committee Hansard*, 19 April 2016, Canberra, p. 2.

84 Law Council of Australia, *Submission 9*, p. 10.

85 JCPA, *Report 326: An Assessment of Tax*, November 1993, pp. 46-48.

86 JCPA, *Report 326: An Assessment of Tax*, November 1993, pp. 54-62.

laws. Therefore, the Review recommended the creation of a Board of Taxation for policy consultation, which has been implemented.<sup>87</sup>

3.110 The AFTS Review in 2009 also covered the issue of a board, finding that an advisory type board would be the most appropriate option for Australia. The Review found support in submissions for the creation of a board, and noted that the revenue agencies in the United States, United Kingdom and Canada had them. In none of these cases did the board interpret the tax laws or make decisions about individual taxpayers.<sup>88</sup>

3.111 The AFTS Review also noted the 2003 Uhrig review of corporate governance of public sector authorities, which argued against a management board for statutory agencies because it would interfere with the line of accountability between the agency and the minister. Therefore, the AFTS Review recommended an advisory board for the ATO on the grounds that it would expand the range of skills and experience available to the organisation but maintain some clarity of responsibility. The report stated:

This would usefully add to, formalise and elevate the existing consultative arrangements that support the Commissioner's management of the ATO ... This should not be seen as a criticism of the current management of the ATO. Rather, the Review's aim is to put the ATO in the best possible position to meet the significant challenges of the future. Though the current management arrangements have served the system well in the past, the pace and significance of changes to the ATO's work mean that it could benefit from additional management arrangements that offer an even greater range of expertise and perspectives.<sup>89</sup>

3.112 The 2013 Budget had an expense measure for creating an advisory board for the ATO. The Committee is not aware of any further action since.<sup>90</sup>

### Committee comment

3.113 A board for the ATO is part of its internal controls and governance, no matter whether the board is of an advisory or management nature.

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87 Review of Business Taxation, *A Tax System Redesigned: More certain, equitable and durable*, July 1999, pp. 119-23.

88 AFTS, *Report to the Treasurer, Part Two, Detailed Analysis, volume 2 of 2*, December 2009, p. 664.

89 AFTS, *Report to the Treasurer, Part Two, Detailed Analysis, volume 2 of 2*, December 2009, p. 665.

90 The measure was to be met within existing ATO resources. The Hon Wayne Swan MP, Deputy Prime Minister and Treasurer and the Hon Penny Wong, Minister for Finance and Deregulation, *Budget Measures, Budget Paper No. 2, 2013-14*, May 2013, p. 272.

Therefore, it would not be part of its external scrutiny and the topic is outside the Committee's terms of reference.

- 3.114 The Committee notes that the Board of Taxation was established in 2000 to provide policy advice.
- 3.115 The Committee also notes that although an advisory board has not been established following the 2013 budget measure, the ATO renewed its consultation processes for advice on individual tax issues in 2013. It now has a smaller number of standing groups and has established a Consultation Hub to manage the consultations on specific matters.<sup>91</sup>
- 3.116 Although not the same as an advisory board, the Capability Review in 2013 provided high-level strategic advice to the ATO about its internal governance, culture and capacities. It has enabled organisation-wide improvements and formed the start point for the Reinvention Program. Future Capability Reviews may be warranted, and may be an alternative to an advisory board for providing organisation-level advice and helping to set the ATO's direction, albeit only every five to 10 years.
- 3.117 The key question in this inquiry is how an internal mechanism, such as a board, affects external scrutiny. AFMA noted that internal controls and external scrutiny are complements, rather than substitutes.<sup>92</sup> Therefore, establishing a board may have little effect on external scrutiny. The Law Council concluded that establishing a board for the ATO 'would not warrant the removal of existing levels of external scrutiny'.<sup>93</sup> The Committee endorses this statement.

## ATO culture and reinvention

- 3.118 The ATO is engaged in a program of renewal which it calls *Reinventing the ATO*. It aims to be known for its service, expertise and integrity. A number of stakeholders have put on record their recognition of the changes taking place. For example, the Group of 100, an organisation of chief financial officers from large corporations, commented on the 'transformative work' of the Commissioner, and especially the newly collaborative approach of the ATO.<sup>94</sup>
- 3.119 Chartered Accountants also commented favourably on the recent undertakings of the ATO:

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91 ATO, *Submission 15*, Appendix 2.

92 AFMA, *Submission 19*, p. 3.

93 Law Council of Australia, *Submission 9*, p. 10.

94 Group of 100, *Submission 4*, p. 1.

... the ATO has embarked upon an ambitious and challenging change program (known as *Reinventing the ATO*) at the same time as addressing a number of developments which have the potential to undermine confidence in the Australian taxation system ... There are also senior ATO personnel currently assisting Treasury with a number of important projects ... particularly at this challenging stage in the ATO's history, management needs some clear air.<sup>95</sup>

- 3.120 However during the inquiry, the Committee also received a number of systemic complaints about the ATO. One example was raised by tax lawyer Graeme Halperin, who found difficulty in arranging for the ATO to engage in **mediation during tax disputes**. The advantages of mediation are obvious. Disputes can be resolved earlier and at less cost. At the minimum, mediation can narrow down a dispute to the key issues. Mr Halperin, who practices law in a range of fields, stated that mediation 'is now part of the dispute resolution culture ... except when engaging with the ATO'. He claims that mediation teams in the ATO are 'sidelined' by other ATO officers, and that alternative dispute resolution is resisted when it is requested. He suggests that ATO officers are 'unfamiliar and uncomfortable' with the approach of settling disputes as early as possible.<sup>96</sup>
- 3.121 Independent Contractors Australia also argued that the ATO's approach to alternative dispute resolution 'is not genuine'.<sup>97</sup>
- 3.122 Mr Halperin also raised the issue of **enforcement and debt collection**. This area can be fraught. Taxpayers may have a legitimate point to raise, but can find themselves in financial difficulty during a dispute and unable to fund their representation. However, if the ATO has reasonable concerns about a taxpayer's compliance, then compliant taxpayers would expect the ATO to make full use of its enforcement powers.
- 3.123 Mr Halperin's concern was that ATO audit teams can spend considerable resources assessing a taxpayer's liability without taking into account their capacity to pay. The assessment may be accurate, but it may result in nothing but an accounting problem because the taxpayer cannot pay.<sup>98</sup>
- 3.124 Independent Contractors Australia raised concerns about how the ATO determines whether a taxpayer is an **employee or contractor**. They argued

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95 CAANZ, *Submission 26*, p. 6.

96 Mr Graeme Halperin, *Submission 5*, p. 2.

97 ICA, *Submission 3*, p. 6.

98 Mr Graeme Halperin, *Submission 5*, p. 3.

that the definition is clear ‘at law and in practice’, and the ATO has a checklist of 11 items to determine it, but that ATO officers had ‘a high level of suspicion’ about self-employed people and whether they are businesses.<sup>99</sup> They apply their own ‘smell test’ rather than the law.<sup>100</sup> Independent Contractors Australia noted that the Commissioner of Taxation has claimed that the ATO ‘is more understanding and is working with small business people’, but they claimed that the situation is deteriorating.<sup>101</sup> Their view was:

... that the ATO cannot be trusted to act fairly, or even to act within the law ... in relation to small business people and that, as a consequence, increased scrutiny and oversight of the ATO is required.<sup>102</sup>

3.125 Independent Contractors Australia also asserted that the ATO makes **allegations of fraud** which are unsubstantiated and where details are not given – a denial of procedural fairness. They argued that the ATO is not acting within the law in many of these cases, but a small business so accused cannot afford legal representation. The fraud accusations in turn allow the ATO to review multiple years of past tax returns, not just the two years or four years that are usually available for review. It then issues large tax claims and penalties.<sup>103</sup>

3.126 The Committee notes that, at the hearing, the ATO offered to independently review any cases provided by Independent Contractors Australia.<sup>104</sup>

3.127 Ernst & Young noted that small businesses in particular may be adversely affected by the **compliance activities** of the ATO. They conceded that the ATO needed to have wide ranging powers, but said that small businesses had been intimidated by extended disputes with the ATO. They argued:

Small businesses often do not have the cash flows or resources to deal with the ATO and disputes can lead to potential insolvency of the business or bankruptcy for the individual taxpayer, regardless of the merits of their position.<sup>105</sup>

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99 ICA, *Submission 3*, p. 4.

100 ICA, *Submission 3*, p. 12.

101 ICA, *Submission 3*, p. 5.

102 ICA, *Submission 3*, p. 6.

103 ICA, *Submission 3*, pp. 9–11.

104 Mr Geoff Leeper, ATO, *Committee Hansard*, 16 March 2016, Canberra, p. 2.

105 Ernst & Young, *Submission 7*, p. 5.

3.128 However, the submission of the Institute of Public Accountants noted that the ATO's program of reform was working, even though there could still be problems:

There have been instances over the years of the ATO being dismissive of feedback, particularly where it conflicts with a strongly entrenched position. This is less likely to be the case today given the significant cultural changes in the ATO of late, but given the sheer size of the organisation, there still remain pockets that are slow in adapting.<sup>106</sup>

### Committee comment

3.129 The Committee notes that many of the issues that have been raised in these submissions also arose in the Committee's inquiry into tax disputes, which focused on small taxpayers and individuals. It identified particular concerns with regard to the ATO's poor engagement with taxpayers before escalating disputes, and where the burden of proof lay in fraud and evasion cases.

3.130 The Committee reinforced an earlier recommendation by the Inspector-General of Taxation, that the ATO should consider whether to engage in direct conferences with taxpayers at multiple points in a dispute. This is in the process of implementation.<sup>107</sup>

3.131 It also recommended, among other things, that:

- findings or suspicion of fraud or evasion be made only by Senior Executive Officers of the ATO
- allegations of fraud be made only when evidence of fraud clearly exists
- allegations of fraud or evasion should be addressed as soon as practicable in an audit or review.<sup>108</sup>

3.132 The ATO undertook to examine these recommendations.<sup>109</sup>

3.133 The Committee also recommended that the Government introduce legislation to place the burden of proof on the ATO in relation to

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106 Institute of Public Accountants, *Submission 24*, p. 1.

107 Australian Government, *Australian Government response to the House of Representatives Standing Committee on Tax and Revenue report: Tax disputes*, December 2015, p. 12.

108 House of Representatives Standing Committee on Tax and Revenue, *Tax disputes*, March 2015, p. xviii.

109 Australian Government, *Australian Government response to the House of Representatives Standing Committee on Tax and Revenue report: Tax disputes*, December 2015, p. 10.

allegations of fraud and evasion after a certain period has elapsed. This recommendation was not accepted.<sup>110</sup>

- 3.134 The Committee reiterates its earlier comments in support of mediation and early engagement, and its previous recommendations to do with the handling of accusations of wrongdoing.
- 3.135 In the tax disputes report, the Committee also recommended that the ATO develop a measurable indicator of taxpayer perceptions of fairness in tax disputes.<sup>111</sup> The ATO has done so, and is generating reports which are useful in supporting the changes suggested above. The Committee commends the ATO for producing this important performance measure.
- 3.136 Overall the Committee believes that the ATO is in the process of a genuine cultural change, and accepts its statement that:
- ... our enterprise-wide transformation program – Reinventing the ATO – is on track and delivering improved and innovative services for taxpayers.<sup>112</sup>
- 3.137 The Committee believes that a change in the culture of a large organisation such as the ATO can take years, and that the senior management and the external scrutineers need to be constantly vigilant over the process during that time for it to come to fruition.
- 3.138 Whilst recognising that significant cultural change takes time, the Committee also believes there are remaining genuine concerns amongst stakeholders. The Committee has highlighted some of the concerns raised in submissions to highlight that completion of the reinvention program is critical to improving the outcomes for taxpayers.
- 3.139 The Committee further commends the Commissioner of Taxation on the breadth of reform that he has undertaken and the significant achievements to date. The Committee encourages continued action and looks forward to seeing the positive outcomes that cultural change will bring to the ATO and its stakeholders.

**Bert van Manen MP**  
**Chair**

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110 House of Representatives Standing Committee on Tax and Revenue, *Tax disputes*, March 2015, pp. xviii–xix.

111 House of Representatives Standing Committee on Tax and Revenue, *Tax disputes*, March 2015, p. xvii.

112 ATO, *Submission 15*, p. 2.

