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The Secretary
House of Representatives Standing Committee on Tax and
Revenue
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11 March 2016

By Email

Dear Sir/Ms

Inquiry into the Scrutiny Arrangements Applied to the ATO

Greenwoods & Herbert Smith Freehills thanks the Committee for the opportunity to make a submission on the Committee's inquiry into the scrutiny arrangements applied to the ATO.

Greenwoods & Herbert Smith Freehills is Australia's largest specialist tax advisory firm, with offices in Sydney, Melbourne and Perth. We advise ASX-listed and other large Australian businesses as well as foreign investors and international financiers with interests in Australia.

Accountability and transparency

We think it self-evident that Australia's taxation system depends critically on voluntary compliance and taxpayer goodwill. Or to put this the other way, no tax administration (of a size that government could fund or the community would tolerate) could ever hope to scrutinise every transaction in the economy for its tax ramifications. While voluntary compliance can be buttressed by ex post verification, third party collection and reporting, and the use of sanctions in selected cases, ultimately most taxpayers on most occasions chose how much effort they will invest to understand their obligations and how closely they will choose to meet Australia's tax laws. Australia is in the fortunate position that most taxpayers comply on most occasions with most of their obligations. This is not the invariable experience internationally, and it is a circumstance we should guard jealously.

Given the critical role of voluntary compliance, it is crucial that taxpayers have confidence in the fairness of the tax obligations they are expected to meet, and in the impartiality of the agency which oversees the rules. Community confidence is fragile and easily lost. This is especially true of confidence in the tax system because it is such a complex, arcane and specialised area, governed by lore and practice as well as express law.

Accountability mechanisms, and systems to ensure transparency of government actions, play an important part in securing the ongoing goodwill of the community. Few things could be more damaging to an effective tax system than the perception that some taxpayers are being favoured or that some taxpayers are being singled out for unfair treatment. The best antidote to that perception is strong accountability mechanisms and adequate systems to ensure the transparency of government action. In former times perhaps public trust in government and government agencies was more willingly offered, but it seems the modern public is more sceptical and requires visible institutionalized guarantees. Hence, *prima facie*, external oversight of the ATO is a good thing and more external scrutiny is preferable to less.

Doc 510710046

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However, external scrutiny is not costless either for the entity which undertakes the scrutiny (or more commonly in most cases, for the government which must fund the oversight body), or for the ATO which must respond to its requests. Consequently, the degree of external scrutiny and the areas on which attention is focussed have to be selected with care – there is a delicate judgment to be made in deciding how much external scrutiny, by whom and over what areas. There are clearly dangers: the ATO will spend excessive amounts of time answering queries from oversight bodies, the scrutiny will be too detailed, one body will duplicate efforts of another, the areas being scrutinised will be poorly chosen, and so on.

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 a fine judgment to be made to determine just how much money should be invested in order to be confident that nothing significant remains to be discovered.

Hence, we commend the Committee for its decision to, ‘inquire into the scrutiny arrangements that apply to the Australian Taxation Office (ATO), with particular regard to removing inefficiency and duplication [and] reducing cost to government ...’ The issue is not straightforward, and the inquiry is timely.

Oversight bodies

Parliament. At present, the administration of the tax system by the ATO is subject to formal ongoing scrutiny by Parliament through the annual Senate Estimates Committee process and the inquiry into the ATO’s annual report conducted by this Committee. The ATO is also subject to formal but more ad hoc oversight by other Committees of the Parliament conducting periodic inquiries that bear upon the work of the ATO – the House of Representatives Economics Committee, the Tax and Revenue Committee, the Senate Economics Committee and the Joint Committee of Public Accounts and Audit.

Examples of these kinds of *ad hoc* inquiries include the Committee’s recent inquiry into Tax Disputes, the Senate Economics Committee’s current inquiry into Corporate Tax Avoidance. The *Commissioner of Taxation’s Annual Report 2014-15* (page 81) notes,

We appeared before the House of Representatives Standing Committee on Tax and Revenue in August 2014 and March 2015. We also appeared with Treasury before three Senate Estimates hearings, responding to approximately 370 questions on notice from these hearings.

We appeared before 13 other parliamentary committees, including:

- *Standing Committee on Tax and Revenue inquiry into tax disputes*
- *Senate Economics Committee inquiry into corporate tax avoidance, and inquiry into digital currency*
- *Standing Committee on Social Policy and Legal Affairs inquiry into the Child Support Program.*

Government oversight agencies

The ATO is also subject to scrutiny by a number of government agencies including the Inspector-General of Taxation, the Australian National Audit Office (ANAO) through its performance reviews (as well as its audits of the ATO’s financial statements), the Commonwealth Ombudsman and potentially other agencies such as the Australia Commission for Law Enforcement Integrity or the Office of the Australian Information Commissioner.

Courts and Tribunals

Another type of formal scrutiny of the ATO’s behaviour occurs through the disputes process. The AAT and Courts exist to rule on the validity of decisions made and actions

taken by the ATO in the course of administering the tax legislation. Of course, these bodies are not the means for comprehensive or systemic oversight of the ATO but they do constrain its activities both in the (few) matters which are litigated but more importantly in the way that precedent sets standards for the ATO's future behaviour and administrative actions.

External consultations and informal investigations

In addition, informal scrutiny occurs through the activities of organisations with an interest in the tax system such as professional bodies (the Law Council, CA ANZ, CPA Australia, The Taxation Institute, the Corporate Tax Association, the Institute of Public Accountants, the NTAA, etc), civil society groups (ACOSS, the Tax Justice Network), journalists in the business press, and even whistle-blowers inside the organisation. The ATO actively seeks input from some of these players through its various consultation forums. While the activities of these people and bodies are not directly within the focus of the Committee, their activities do bear upon the Committee's decisions about appropriate mechanisms for 'reducing cost to government ...'

Focus for oversight

We consider it appropriate for the ATO to remain subject to a rigorous and co-ordinated regime of external scrutiny, but at present there are indications that the external scrutiny is somewhat haphazard, spasmodic and misdirected in places.

It is helpful to think of external scrutiny as being directed at systemic issues or to operational issues:

- financial probity is a particular dimension of systemic performance, and there is a role for a specialist external authority (traditionally, the Auditor General) to examine the financial probity of a government agency. The Senate Estimates Committee process and the work of the Joint Committee of Public Accounts and Audit are directed to issues of financial probity *inter alia*;
- there is also a role for some external authority to examine the more general administration of a government agency and recommend improvements to processes and solutions to systemic problems that are observed. Both Houses of Parliament are involved in this work. The current Senate Economics Committee's inquiry into *Corporate Tax Avoidance* is an example of a project that will likely have recommendations touching on the functioning of the ATO (as well as possibly recommending changes to law). Overseeing the administration of individual ATO programs and projects is also undertaken by the ANAO in its performance audits. An example is the ANAO's audit of the *Administration of Capital Gains Tax for Individual and Small Business Taxpayers* in 2015 or the 2014 report on *Annual Compliance Arrangements with Large Corporate Taxpayers*. This focus on systemic issues in the running of the ATO was the rationale for the office of the Inspector-General of Taxation when it was established in 2003. The original mandate of the office was to review and report on the, 'systems established by the Australian Taxation Office to administer the tax laws ...' While the Commonwealth Ombudsman focuses mainly on individual operational complaints, it also has a role to suggest solutions to systemic failings it uncovers as part of that process; and
- there is a role for an authority to investigate operational issues – that is, specific complaints about the treatment of individual citizens and the behaviour of the ATO in handling particular cases. This function could occur outside the curial process as in the case of investigations undertaken by the Commonwealth Ombudsman. This function was conferred on the Inspector-General in 2015. It can also occur in the much more formalised dispute settlement processes of the AAT and courts, though these processes are not readily accessible for most taxpayers because of the cost and complexity involved.

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In our submission there is clearly room for rationalising the number of external agencies to prevent duplication, and clarify and focus their work to ensure more even coverage of issues, better specialisation, and ultimately more effective and more cost-effective scrutiny.

Systemic issues

It is clear from our earlier recitation that the Inspector-General, the ANAO and the Parliamentary Committees all focus their attentions on systemic matters. However, as the decisions on the topics to examine are all largely self-determined, there is the potential for duplication and repetition of inquiries, and, given that these are all publicly-funded agencies, there is the potential for the waste of resources.

One matter which may merit some attention is agenda-setting: whether there needs to be some centralised control and better co-ordination in the choice of topics to be examined. It seems proper that this co-ordination function would rest with the Parliamentary Committees. They would decide which matters are sufficiently important and sufficiently pervasive to merit investigation, and whether that inquiry ought to be undertaken by the Committee itself, or would be better undertaken by the ANAO or the Inspector-General.

Complaints

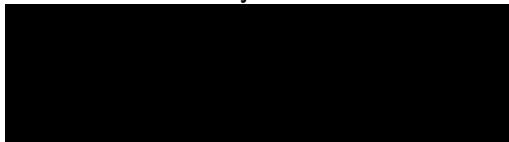
Another area which appears ripe for rationalisation is the oversight of complaints. Complaint-handling processes are probably best handled, at least initially, within a dedicated complaints unit inside the ATO. Such a regime would, of course, be buttressed by retaining the right of ultimate recourse to the AAT and courts, or to less formal mediation processes of the kind undertaken internally or by an external ombudsman. But a properly-resourced internal complaints unit with a high level of independence and authority to negotiate settlements is an appropriate method of handling many disputes, and one which can meet the community's expectations for a fair hearing. In this respect, the ATO experiment begun in 2013 for the 'Independent Review' of disputes involving large taxpayers appears to us a good model to expand. As the Inspector-General's 2015 report into *The Management of Tax Disputes* notes, 'stakeholders have acknowledged recent improvements in the ATO's handling of tax disputes ...' and the Independent Review process is rightly praised as a good model to expand to remove the problem of, '[the] unavailability of the pre-assessment reviews, such as the above IR process, to all taxpayers ...'

There is also a role for an external authority to review the design and operation of the ATO's internal dispute-handling processes, but that function should principally inquire into systemic matters about the procedures, rather than the examination of individual cases.

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We trust these comments are useful for your inquiry. Please contact the author if anything in this submission is unclear or you would like further elaboration of any matter.

Yours sincerely



Tony Frost
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