

## Chapter 6

### RULINGS

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#### The Taxation Rulings System

6.1 A taxation Ruling is an official interpretation of tax law provided by the Commissioner of Taxation. There are several types of Rulings issued by the Australian Taxation Office (ATO). They are:

- . Public Rulings issued up to 30 June 1992;
- . Public Rulings issued after 30 June 1992;
- . Private Rulings; and
- . Determinations.

6.2 Rulings and Determinations may cover any one of the laws administered by the ATO. Rulings issued to date include those explaining the following areas of law:

- . Income Tax (Various Acts);
- . Sales Tax (Various Acts);
- . *Administration Decisions (Judicial Review) Act 1977*;<sup>1</sup>

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1. Ruling issued in respect of how this Act will apply to the ATO.

- . *Administrative Appeals Tribunal Act 1975*;<sup>2</sup>
- . *Bank Accounts Debits Tax Administration Act 1982*;<sup>3</sup>
- . *Fringe Benefits Tax Amendment Act 1986*;
- . *Petroleum Resources Rent Tax Amendment Act 1987*;<sup>4</sup>
- . *Training Guarantee (Administration) Act 1990*;<sup>5</sup> and
- . *Superannuation Guarantee (Administration) Act 1992*.<sup>6</sup>

6.3 In this chapter the Committee has focused on three of the Rulings series:

- . Public Rulings made after 30 June 1992;
- . Private Rulings; and
- . Determinations.

6.4 There is no statutory definition of what constitutes a Ruling. However, the *Taxation Administration Act 1953* states that a public Ruling means a Ruling under s. 14ZAAE, s. 14ZAAF and s. 14ZAAG of that Act. From those sections a public Ruling may be considered to be:

A Determination of the Commissioner of the way in which a tax law or tax laws would apply to any person in relation to a class of arrangements, a class of persons in relation to an arrangement, or a class of persons in relation to a class of arrangements.<sup>7</sup>

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2. Ruling issued in respect of how this Act will apply to the ATO.
  3. ATO no longer administers this Act.
  4. Rulings issued under this Act are not binding Public Rulings in terms of the *Taxation Administration Act 1953*.
  5. Rulings issued under this Act are not binding Public Rulings for the purposes of the *Taxation Administration Act 1953*.
  6. Rulings issued under this Act are not binding Public Rulings for the purposes of the *Taxation Administration Act 1953*.
  7. *Taxation Administration Act 1953* ss.14ZAAE, 14ZAAF, 14ZAAG.

6.5 A copy of a public Ruling is included for reference at Appendix 9. Interestingly, s. 14ZAAD of the *Taxation Administration Act 1953*, which states that a public Ruling may be a Ruling on the way in which a discretion of the Commissioner may be exercised, is not defined as a public Ruling in the Interpretation section of the Act.

6.6 In the same manner, a private Ruling is defined to be a Ruling applied for under s. 14ZAF or s. 14ZAG of the *Taxation Administration Act 1953* and a Ruling made under s. 14ZAP of that Act. In general a private Ruling can be considered to be:

A written response from the Commissioner to a request for a Ruling about the way in which a tax law or tax laws would apply to a specific arrangement or arrangements entered into, or proposed to be entered into, by a specific taxpayer.<sup>8</sup>

6.7 A copy of a private Ruling (with personal information deleted) is included for reference at Appendix 10. Once again the Committee noted that s. 14ZAE of the *Taxation Administration Act 1953* provides that a private Ruling may be a Ruling on the way in which a discretion of the Commissioner may be exercised. However the interpretation provision which gives the meaning of private Ruling does not include s. 14ZAE.

6.8 Determinations, as their title implies, are expressions of the view of the Commissioner upon the effect of a particular taxation provision in a given situation. There is no statutory basis for Determinations. Usually Determinations seek to address single issues which may be common or significant to taxpayers without providing a comprehensive analysis of the entire law relating to that subject.<sup>9</sup> A copy of a Determination is included for reference at Appendix 11.

6.9 Taxation Determinations can have the status of public Rulings and therefore be made binding upon the Commissioner.<sup>10</sup> Taxation Ruling TR92/1 sets out when a Determination can be a public Ruling and the circumstances in which the Commissioner is bound by the Determination. Determinations must therefore be considered to be more than interim expressions of the view of the ATO as they may be administratively converted to public Rulings. Moreover, it is possible that a

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8. *ibid.*

9. Evidence, vol. 4, p. S993.

10. Evidence, vol. 22, p. S5142.

Determination will be subsequently followed by the release of a fully reasoned public Ruling.<sup>11</sup> But this is not however necessarily the case.

6.10 The origins of the system of income tax Rulings were described by the Senate Standing Committee on Legal and Constitutional Affairs (the Senate Committee) in a 1987 Report, *Income Taxation Rulings*, and were restated by the ATO in its Submission to the Committee.<sup>12</sup> The Committee noted in particular, the role the *Freedom of Information Act 1982* had played in the formal publication and release of income tax Rulings.

6.11 The first official taxation Ruling was issued on 6 December 1982 to coincide with the commencement of the *Freedom of Information Act 1982*. Until that date, official advice to taxpayers from the ATO in respect of new or revised interpretations of the tax law were issued in various forms including public Information Bulletins and ATO Memoranda.<sup>13</sup>

6.12 Taxation Ruling No. 1 set out the circumstances in which a Ruling would be issued. In the preamble to the Ruling, it was stated that a Ruling would be issued in respect of any decisions which satisfied the following criteria:

- (a) provides an interpretation, guideline, precedent practice or procedure to be followed in making a decision that effects the rights or liabilities of taxpayers;
- (b) establishes a new or revised interpretation of our administration of the tax laws; and
- (c) affects all taxpayers or a section of the tax-paying community, ie., not simply an individual instance.<sup>14</sup>

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11. Evidence, vol. 4, p. S993.

12. Senate Standing Committee on Legal and Constitutional Affairs, *Income Taxation Rulings*, AGPS, Canberra, November 1987, p. 1; Evidence, vol. 4, p. S985.

13. Evidence, vol. 4, p. S984.

14. Senate Standing Committee on Legal and Constitutional Affairs, op. cit., p. 1.

6.13 The Senate Committee proposed two principal reasons for a public Rulings program. They were:

- . to explain how the Commissioner of Taxation proposes to exercise the various discretions conferred upon him by the income tax Acts; and
- . to explain how the Commissioner will interpret the Acts or explain the ramifications of court decisions.<sup>15</sup>

6.14 The Committee noted the general support of taxpayers and their representatives for the program of Rulings. As the Commissioner of Taxation has the statutory power to administer the taxation laws it was considered important that the Commissioner make known to taxpayers how those powers were to be exercised. Clearly the provision of some information by the ATO was considered preferable to none at all.<sup>16</sup>

## Preparation

6.15 In evidence to the Committee, the ATO described the process by which public Rulings were prepared and released. The Committee considered this evidence and noted certain criticisms of the process. A flowchart demonstrating the process for the preparation of public Rulings is included as *Figure 6.1*.

6.16 In short, public Rulings are produced by the ATO according to an agreed publicly available program.<sup>17</sup> The program is determined after consultation with groups within and external to the ATO. A Taxation Rulings Committee on which external representatives of taxpayer groups and professionals sit, broadly oversees the program.

6.17 Issues for incorporation in public Rulings are identified by a number of groups. They include the ATO's Audit, Appeals and Review, Legislative Services and Taxpayer Assistance Groups, the ATO's specialist cells, taxpayer representatives sitting on the Commissioner's Advisory Panel and the Tax Liaison Group. Issues are also identified through representations by individual taxpayers.

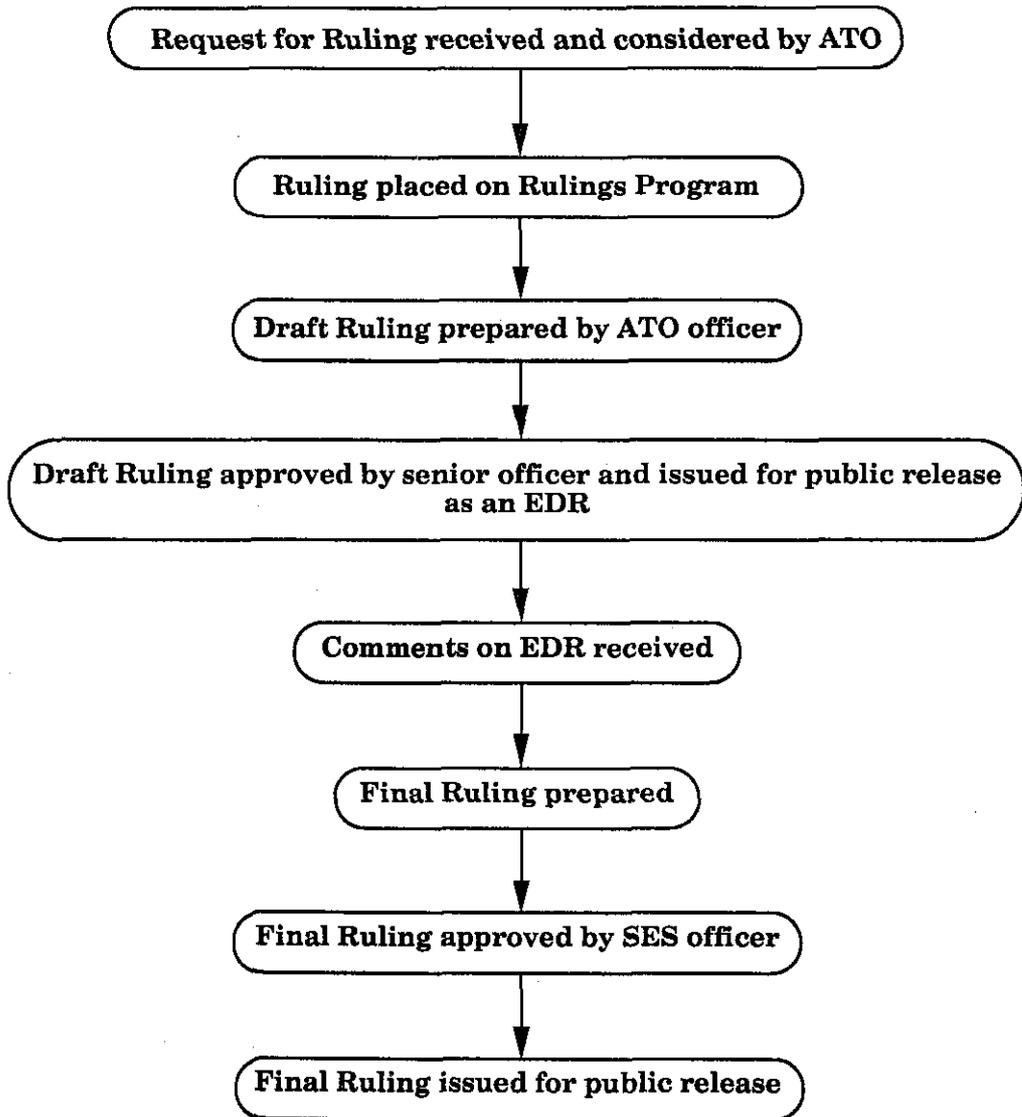
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15. *ibid.*, p. 3.

16. *Evidence*, vol. 2, p. 490.

17. *Evidence*, vol. 4, p. S989.

Figure 6.1 The Process for the Preparation of Rulings<sup>17</sup>



17. Evidence, vol. 4, p. S992.

6.18 Public Rulings may be prepared by staff in any of the ATO's branch offices, however the majority continue to be prepared by staff in the national office. In accordance with a program of devolving administrative responsibility, the ATO has recently conducted training for officers in branch offices in the preparation of public Rulings. This training has concentrated on the technical skills and processes for issuing Rulings.<sup>19</sup> Officers above the level of Senior Officer Grade B can have the delegated authority to issue and withdraw a general Ruling.<sup>20</sup>

6.19 The degree of devolution in the function of preparing public Rulings was evident in statistics provided to the Committee:

In the period 1 July 1992 to 30 June 1993, 46 final taxation Rulings were issued by the ATO. Of these, 35 Rulings were issued from the national office of the ATO, 10 from various branch offices and 1 from a specialist cell.<sup>21</sup>

6.20 Following the preparation of a draft Ruling and clearance by a senior officer within the ATO, the draft is provided, to parties both within and outside the ATO for review. The draft is known as an Exposure Draft Ruling (EDR). Twenty working days are generally allowed for comments on the EDR to be provided to the ATO, although this comment period may be as long as six weeks.<sup>22</sup> These comments are then considered and following any further amendment, or refinement, the EDR is approved by a Senior Executive Service officer within the ATO and released as a final public Ruling. The level of consultation allowed in the preparation of Rulings was both commended and criticised in evidence to the Committee.<sup>23</sup> In particular, the Committee noted suggestions that the Commissioner had failed on at least 50% of occasions to include the views of external parties in the final issued Rulings.<sup>24</sup>

6.21 The Committee recognised the importance of consultation and discussion as being fundamental to the preparation of good, balanced Rulings. While discussion and consultation can clearly delay a Ruling's release, the Committee considered it imperative that the views of all parties interested in a Ruling's application be sought, considered, acknowledged and, where appropriate, incorporated in the issued Ruling. This was particularly true where a Ruling provides an interpretation of the law.

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19. Evidence, vol. 4, p. S991.

20. Evidence, vol. 22, p. S5192.

21. Evidence, vol. 22, p. S5145.

22. Evidence, vol. 5, p. 1548.

23. Evidence, vol. 4, pp. S624, S851; vol. 13, p. S2496.

24. Evidence, vol. 14, p. S2842.

6.22 The Committee noted that during the course of its Inquiry, the ATO amended its procedures for the preparation of public Rulings in a number of ways, including increasing the amount of time allowed for comments on draft Rulings and the development of pre-Ruling consultative documents on contentious issues. These documents are intended to provide a vehicle for early discussion of the issues in a particular topic prior to the formal preparation of a draft Ruling. The Committee supported the further development of this consultative process.

6.23 Furthermore, the Committee was advised that where necessary, Rulings were to be prepared, with an acknowledgment that differing views existed as to the proper interpretation of the law.<sup>25</sup> Such a development was considered critical by the Committee as it acknowledged the perception in the community that the view of the Commissioner, as expressed in Rulings, had taken on the status of quasi-law. This conclusion was justified by the penalties which could apply for taxpayers who failed to follow a Commissioner's Ruling in their assessment. The Committee considered that the inclusion of alternative views in Rulings would serve to add balance to the public perception of Rulings and concluded that, where alternative interpretations of the law on which the Commissioner was preparing a Ruling were provided to the Commissioner, the subsequent public Ruling should be issued in a manner which both acknowledged that those alternative views existed and provided the substance of the disagreement.

6.24 While the Ruling would remain the view of the Commissioner, the ethos of a self assessment system made it crucial that alternative views of the law be recognised. Moreover, the Committee considered the publication of significant alternative views should indicate to the Commissioner that the urgent clarification of the legislative text was necessary. The Committee strongly rejected the concept of an administrative officer imposing a view of the law on citizens, when it was clear that there were serious doubts as to the validity of that view.

6.25 In such cases the Committee considered it was imperative that the Commissioner seek clarification of the law rather than assessing taxpayers on the basis of a doubtful interpretation. This would require the Commissioner to approach the relevant Minister indicating the existence of significant uncertainty in the provisions of the Act and to seek legislative clarification. The Minister would then introduce legislation to clarify the law and the Parliament would be able to give guidance to the Commissioner through the clarification of the law. While the Committee recognises that this procedure is currently available, it concludes that the Commissioner should be more willing to seek legislative clarification.

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25. Evidence, vol. 18, p. S4140.

- . **the Commissioner of Taxation acknowledge in a public Ruling the existence of alternative interpretations of the law to that which has been taken in the Ruling;**
- . **where an acknowledgment of alternative interpretations of the law is included in a public Ruling, the Commissioner of Taxation outline the basis of those alternative views; and**
- . **where the Commissioner of Taxation is provided with arguments evidencing a serious doubt as to the validity of an interpretation in a Ruling, the Commissioner refrain from making a public Ruling pending the clarification of the law.**

6.27 While in theory all Rulings represent the view of the Commissioner of Taxation, in practice Rulings are prepared and released by officers acting on the delegated authority of the Commissioner. The Committee noted proposals from representatives of taxpayers which sought to have Rulings issued by a body independent of the ATO. Such proposals would require a change in the status of Rulings as they envisage that Rulings would represent a concluded and agreed view of the meaning of the law.

6.28 Against this proposal, the ATO argued that Rulings represent the Commissioner's considered view of the law and not the law itself. Consequently, there was no need to require a third party to vet the Commissioner's Rulings. Moreover, the substance of many Rulings was not conducive to third party review as they were effectively internal administrative instructions.

6.29 The Committee noted the significance of Rulings to the efficiency of the taxation system and the standing that Rulings had achieved. Regardless of the theoretical position of Rulings as mere interpretation and advice, the Committee considered the practicabilities of challenging Rulings, effectively granted Rulings a status of quasi-law. The Committee concluded that the issuing of Rulings by a non-judicial third party, would not serve to improve the efficiency of the Rulings program and would detract from the proper balance between the administrative functions exercised by Executive Government and the legislative power of the Parliament.

6.30 However, in view of the Committee's recommendation in Chapter 3 regarding the establishment of a Taxation Commission, the Committee considers that all public Rulings prepared by staff of the Commission should be formally

approved by the Commission prior to their release. In this way high level supervision of the Rulings program could be effected. The Commission would have the capacity to establish advisory committees for the purpose of receiving external advice on highly contentious subjects. The Commission could thus recommend issues for legislative clarification and a broader perspective on the operation of Rulings would be achieved.

6.31           **The Committee recommends that:**

**all public Rulings be subject to formal approval by the proposed Australian Taxation Commission prior to their release.**

6.32           While the procedures outlined in paragraphs 6.16-6.20 for the preparation of public Rulings were proffered by the ATO as the standard method of preparation and release, the Committee found that, under the law, no specific definition of what constituted a Ruling existed. Indeed, one witness raised the possibility of the Commissioner's speeches, answers to questions in public forums and, as previously noted, taxation Determinations being granted the status of public Rulings on the basis of declaration and publication.<sup>26</sup> The Committee noted that the Explanatory Memoranda to the *Taxation Laws Amendment (Self Assessment) Act 1992*, expressly recognised the possibility of Commissioner's press statements and speeches, ATO return form guides and information booklets all holding the status of public Rulings.<sup>27</sup>

6.33           The Committee considered the lack of precision as to what constituted a public Ruling needed to be clarified by law. While the Committee recognised the difficulty in requiring a particular form for a public Ruling, it considered that taxpayers had the right to know, without doubt, whether a public Ruling had been issued.

6.34           The Committee concluded that the *Taxation Administration Act 1953* needed to be amended to define the meaning of the term 'published'. In the Committee's view a public Ruling should only be considered to have been published when details of the Ruling have been listed in the Commonwealth Gazette.

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26. Evidence, vol. 2, p. 485.

27. *Taxation Laws Amendment (Self Assessment) Bill 1992*, Explanatory Memoranda, p. 29.

6.35 Moreover, the Committee considers there is an opportunity for public Rulings to be made available to interested parties through the utilisation of its computer facilities. In particular, the Committee considers the ATO should make available to subscribers, the ATO's legal information database on which public Rulings are maintained. Access to this database should be made available to Members of Parliament through the Parliament's own Parliamentary database system.

6.36 Therefore the Committee recommends that:

- . for the purposes of Section 14ZAAJ of the *Taxation Administration Act 1953*, a public Ruling be defined to have been published only when notice of the Ruling is published in the Commonwealth Gazette;
- . a notice of publication for the purposes of the gazettal of public Rulings include the reference number and subject heading of the Ruling, together with a brief general description of the Ruling's effect, along the lines of the current head note to public Rulings; and
- . the Australian Taxation Office make available, on subscription, access to the information database on which the Commissioner's public Rulings are maintained.

### **Supervision of Public Rulings**

6.37 Having considered the difficulty in determining what constitutes a Ruling, the Committee examined the methods by which public Rulings are issued and scrutinised. The Committee noted the level of consultation that the ATO engages in prior to a Ruling's release and, as mentioned above, was concerned at suggestions that the ATO did not give due recognition to alternative views.

6.38 The Committee considered the level of scrutiny given to public Rulings by the Parliament. Currently Rulings are listed in the Commissioner's Annual Report which is tabled in the Parliament. While this enables the Parliament to know what public Rulings have been made, it does not provide for the Parliament to formally comment on the Rulings. The Committee also considered that the importance of Rulings required that they be scrutinised by the Parliament in a timely fashion. An annual report does not allow the Parliament to consider some Rulings until more than twelve months after their publication. At the same time the

Committee recognised that the capacity existed for any Member of Parliament to raise the substance of a Ruling in Parliamentary debate.

6.39 The Committee therefore considered alternatives to the current arrangements and in particular, proposals to require public Rulings to be issued or approved by the Parliament.

6.40 In 1987, the Senate Standing Committee on Legal and Constitutional Affairs considered a proposal to make public Rulings subordinate legislation.<sup>28</sup> At that time, Rulings were not binding on the Commissioner and the Senate Committee determined Rulings should not be binding.<sup>29</sup> It was therefore not appropriate to provide a legislative base for the Rulings. However, in the *Taxation Laws Amendment (Self Assessment) Act 1992*, Rulings, both public and private, were made binding upon the Commissioner.

6.41 Furthermore, the Committee considered the implementation of a system of full self assessment to be significant in that the changed assessment environment placed considerably more responsibility for the Determination of a taxation liability upon taxpayers compared to that which existed in 1987. The Committee noted that the Senate Committee had determined that Rulings should not be made in the form of statutory rules, on the basis of the merit of three arguments. Those arguments were:

- . that if the substance of Rulings could be put in statutory form then it should be in the Acts not in a further layer of statutory material;
- . the problem of Parliamentary sitting patterns; and
- . statutory form would not guarantee certainly.<sup>30</sup>

6.42 Evidence was presented to the Committee on the status of public Rulings. The ATO urged the Committee to consider Rulings as statements of the Commissioner's view of the law formed against the background of synthesising information from many sources.<sup>31</sup> The significance of this understanding of the status of Rulings lies in the recognition that they are not law of themselves. That

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28. Senate Standing Committee on Legal and Constitutional Affairs, *Income Taxation Rulings*, AGPS, Canberra, November 1987, p.14.

29. *ibid.*, p. 21.

30. *ibid.*, pp. 14-6.

31. *ibid.*

is, not only is there no legislative requirement on the Commissioner to issue Rulings but as well no legal obligation on a taxpayer should result from the mere issuing of a Ruling. The Committee recognised that this interpretation of the role of Rulings was correct. However, it was concerned at suggestions that Rulings were increasing uncertainty and unfairness by amending the generally accepted meaning of the law even after many years of settled interpretation and that the Commissioner was using the Rulings to remedy legislative deficiencies or inadequacies.<sup>32</sup>

6.43 While acknowledging the theoretical accuracy of the ATO's position, the Committee noted the general perception in the community that Rulings were in fact quasi-law. That is, Rulings had to be followed if taxpayers did not want to be penalised. An important change introduced by the *Taxation Laws Amendment (Self Assessment) Act 1992*, was the imposition of an administrative penalty upon taxpayers who applied for and received a private Ruling before the lodgement of their relevant income tax return and failed to lodge their return on the basis of the Ruling. In addition, public Rulings were given the status of authorities to be taken into account in determining whether a taxpayer had a reasonably arguable position for the purposes of determining a culpability penalty for a tax shortfall. The status of Rulings was thereby elevated, by the legislative amendments, to something more akin to a judicial opinion. Consequently, the opinion of the Commissioner was elevated above that of any other adviser.

6.44 In the Committee's view, this fundamental change in the standing of the Commissioner's Rulings significantly altered the operative effect of Rulings compared to the circumstances considered by the Senate Committee in 1987. So fundamental was this alignment of the status of Rulings that the Committee considered it called into question the fundamental principle of the role of the Parliament as the body responsible for the making of the taxation law. The creation of a system in which the Commissioner's interpretation of the law was supported by statutory penalties had clothed the ATO's Rulings with a status in excess of mere information.

6.45 The Committee noted that public Rulings were 'relevant authorities' for the purposes of determining whether a taxpayer held a reasonably arguable position.<sup>33</sup> That is, when a taxpayer adopted a position in their assessment which was contrary to that considered correct by the Commissioner, the Commissioner would assess the taxpayer's taxation liability in accordance with the ATO's view of the law as expressed in a public Ruling. The Commissioner would then determine whether the taxpayer held a reasonably arguable position. However, in making that judgement, the Commissioner's Ruling would be, amongst other things, weighed

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32. Evidence, vol. 2, p. S145; vol. 4, pp. 1071-3.

33. *Income Tax Assessment Act 1936*, s.160ARZD(5).

against the interpretation of the taxpayer. 'The position taken by the taxpayer would only be reasonably arguable if it could be concluded, by the Commissioner, that the taxpayer's position was 'about as likely as not correct.'

6.46 As the taxpayer must therefore, in effect, demonstrate that the Commissioner's view of the law, as expressed in the public Ruling was wrong and not merely likely to be wrong, the Committee concluded that the weight of the Commissioner's view had been given a standing in law above that of other interpretations or opinions. The Committee did not consider that taxpayers who recklessly or frivolously ignored the Commissioner's opinion should necessarily escape punishment. However, the decision to penalise such taxpayers should always be based on objective evidence. In the Committee's opinion the current system penalised any taxpayer who challenged the Commissioner's interpretations regardless of the intent behind that challenge. The Committee concluded that failure to follow a public Ruling of the Commissioner of Taxation should not of itself be grounds for any penalty. Only evidence of intention to evade a tax obligation should form the basis of a penalty. Comment on the operation of culpability penalties is included in Chapter 12.

6.47 The Committee recognised that the efficient administration of the taxation system required that the Commissioner be able to provide timely advice to taxpayers in respect of how the ATO intends to interpret and apply the law. In the Committee's opinion the Rulings of the Commissioner should be both in theory and in practice no more than advice. At the same time, because the Commissioner was interpreting the legislative provisions and intent of the Parliament, the Committee considered the Parliament, through its committees, should be able to review, evaluate and comment upon the Commissioner's public Rulings. Moreover, the Commissioner should be required to appear before those committees, as necessary, to defend the positions taken in public Rulings, both in respect of interpretation and the manner in which the Commissioner administers the legislative provisions.

6.48 The Committee examined a number of options for facilitating Parliamentary scrutiny of the Commissioner's Rulings. Two options were thoroughly examined:

- . making public Rulings subject to tabling and disallowance; and
- . requiring that Rulings be available for examination by Parliamentary committees.

## Tabling and Disallowance

6.49 For public Rulings to be subject to tabling and disallowance there would need to be amendments to the law to establish the Rulings as delegated legislation. This would involve providing the Commissioner of Taxation with the power to make law through the Rulings. This power would then be supervised by the Parliament through the requirement to table all Rulings for possible disallowance. As Rulings represent a view of the law, in effect through the tabling and disallowance procedures the Parliament would both create and interpret law.

6.50 As a form of delegated legislation, when Rulings were made they would have to be notified in the Commonwealth Gazette and then laid, within a specified period, before both Houses of the Parliament. The Ruling would therefore be subject to the Parliament's scrutiny and the Parliament's ultimate power of veto. The Committee noted that various procedures existed for the handling of delegated legislation within the Parliament. If the Act from which the authority to make delegated legislation, such as a regulation, does not specify the time limits for the lodgement of the regulation before the Parliament, the *Acts Interpretation Act 1901* would apply. That Act specifies that the regulations shall be laid before each House within 15 sitting days after having been made.

6.51 Once laid before the Parliament, either House may, in pursuance of a motion which has been given within 15 sitting days after the regulations have been laid before that House, pass a resolution disallowing the regulation. The regulation thereupon ceases to have effect and, legally, the regulation would be considered to have never been made. If a motion for disallowance has not been withdrawn or otherwise disposed of, that is, passed or rejected, at the expiration of 15 sitting days after notice was given, the regulation specified in the motion would then be deemed to have been disallowed.

6.52 If, before the expiration of 15 sitting days after a notice of disallowance had been given, the House was dissolved or the Parliament prorogued, and the motion had not been withdrawn or otherwise disposed of, the regulation would be deemed to have been laid before the House on the first sitting day after dissolution. Any notice to disallow given in the previous session or the last session of the previous Parliament would need to be given again to have effect.

6.53 The Committee noted that where a regulation had been disallowed or was deemed to have been disallowed, no regulation being the same in substance could be made within six months of the date of disallowance unless the House concerned had rescinded its resolution of disallowance or approved the re-making of the regulation. The Committee further noted that an Act may specifically allow for the disallowance of part of a regulation made under its authority. However, as

the *Acts Interpretation Act 1901* refers to the disallowance of regulations in their entirety, the Committee considered there may be doubt as to the effectiveness of a partial disallowance.

6.54 In considering the proposal to make the Commissioner's public Rulings disallowable as regulations the Committee paid particular attention to:

- . the fact that the current Rulings were not specifically made pursuant to an Act and that there was no requirement for the Commissioner to issue Rulings;
- . the pattern of Parliamentary sittings;
- . the potential for increased uncertainty for taxpayers as a result of disallowance; and
- . the effect disallowance would have on the Commissioner's ability to administer the taxation Acts.

6.55 The Commissioner's Rulings are not made pursuant to any Act of Parliament. That is, the preparation of Rulings is an administrative and not a legal function. As noted above, Rulings were originally the internal instructions of the Commissioner of Taxation to the staff of the ATO on administrative issues concerning how the ATO was to perform its task of administering the tax law. As part of these instructions, it was necessary for the Commissioner, on occasions, to detail to staff how taxpayers' returns were to be assessed in given situations. Through this development the Commissioner's Rulings came to be seen as a collection of the ATO's interpretations of the law.

6.56 While the *Taxation Laws Amendment (Self Assessment) Act 1992* made Rulings binding on the Commissioner, it at no time established a requirement upon the Commissioner to make public Rulings. Moreover, that Act identified that the Commissioner could provide advice to staff in many different forms which would not constitute a public Ruling for the purposes of the law. Most significantly, the operation of the *Income Tax Assessment Act 1936* does not depend on the existence of Rulings and the Rulings do not amend the provisions of that Act. The Committee therefore concluded that Rulings were quite distinctive creatures and distinguishable in character from delegated legislation.

6.57 Nevertheless, the Committee recognised the possibility of converting public Rulings to the status of delegated legislation. As previously noted, this would necessitate a fundamental change in the law in that it would require that the

Parliament give the Commissioner of Taxation the power to make law, subject to the Parliament's scrutiny. The Commissioner's views, as expressed in Rulings, would therefore become statements of the law and would be binding on taxpayers.

6.58 The Committee noted several outcomes which it was argued weighed against undertaking this course of action. They were:

- . the likelihood that the Commissioner would take longer to produce Rulings and would rely on other mechanisms for providing advice to ATO staff;
- . the possibility of the Commissioner issuing all instructions as Rulings and 'flooding' the Parliament;
- . the use of Rulings to amend technical corrections; and
- . the effective transfer of the role of interpretation from the Judiciary to the Parliament.<sup>34</sup>

6.59 The Committee examined the practical difficulties raised by these possible outcomes. The Committee concluded that several of these outcomes were most unlikely given that Parliamentary scrutiny would effectively discipline the Commissioner in the issue of Rulings. Those technical corrections that should *properly be considered in the primary legislation could be detected by a committee.* This function is currently performed in the Senate by the Regulations and Ordinances Committee. Moreover, the consequences of disallowance would be a sufficient deterrent to prevent the Commissioner from flooding the Parliament.

6.60 The Committee noted the importance of Rulings to the information base of taxpayers and, in particular, the importance the taxation industry placed upon the timeliness of Rulings. While a Ruling could operate until such time as it was disallowed, and thus both taxpayers and the Commissioner could assess on the basis of the Ruling, the Committee noted the possible time delays that might occur in having Rulings confirmed as a consequence of the pattern of Parliamentary sittings. The Committee was also cognisant of the consequences of the intervention of federal elections for the period in which Rulings would effectively be in a state of limbo.

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34. Evidence, vol. 13, pp. S2497-9.

6.61 Given that a Ruling would be effective until such time as it was disallowed, the Committee recognised the administrative problems for both the Commissioner and taxpayers which would flow from acting upon a Ruling which might later be disallowed. In the event that the Commissioner determined not to issue assessments until the Ruling had been formally approved, it was possible that assessments might be delayed by as much as twelve months. Such an outcome was considered by the Committee to be unacceptable.

6.62 Furthermore, the Committee considered the implications for taxation administration if the Commissioner were to assess on the basis of a Ruling which was later disallowed. In such circumstances, the Commissioner would be required to reassess the taxpayer. However, as a regulation can only be rejected and not amended, the Commissioner would have no guidance from the Parliament as to the meaning of the provisions of the primary Act. This situation would be exacerbated in the circumstances where the government of the day supported the Commissioner's original Ruling.

6.63 Taxpayers would also have the problem of greater uncertainty if Rulings were made regulations. Self assessment requires that the taxpayer understand the law prior to making an assessment. If a Ruling were pending in the Parliament, and the passage of the Ruling would establish the law as if it had always been the case, the taxpayer would need to take the Ruling into account in self assessing. However, if the Ruling were disallowed the taxpayer would have been assessed on the basis of a false interpretation of the law. In effect the taxpayer would be forced to defer making an assessment until such time as the Ruling had been either passed or disallowed by the Parliament. Once again, the possible time delays in these circumstances would be unacceptable.

6.64 While the Committee was not aware of any procedural difficulties in the tabling and disallowance proposal, it considered the practical difficulties were significant and did not warrant at this time fundamentally altering the Rulings procedure. Moreover, the Committee considered its recommendations in respect of the notification of significant alternative views within Rulings and the removal of penalties for merely failing to follow a Ruling, would restore the Rulings to their essential character; that is, opinions of the Commissioner.

6.65 Although of this view, the Committee considers the Commissioner's public Rulings should be made available to the Parliament for scrutiny by committees on a regular basis. At the very least, the Committee considers public Rulings should be tabled in the Parliament within five sitting days of their having been published. Through the Parliament's committee system, the public Rulings could then be evaluated and analysed. Public hearings at which both taxpayers, their representatives and the Commissioner could appear, would provide a platform for the public scrutiny of the Commissioner's actions. The merit of public Rulings, from

both an administrative and legal perspective, would thereby be tested and possible action in response to unsatisfactory Rulings could be recommended to the Parliament.

6.66           **The Committee recommends that:**

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full versions of all public Rulings issued by the Commissioner of Taxation be tabled in the Parliament within five sitting days of notice of their publication being included in the Commonwealth Gazette.

### **Private Rulings**

6.67           As noted previously, private Rulings are prepared by the ATO for individual taxpayers. Following the enactment of the *Taxation Laws Amendment (Self Assessment) Act 1992*, taxpayers may apply for a private Ruling in respect of a matter that affects them or with the written consent of another about a matter that affects the other person.<sup>35</sup> Class Rulings are also possible.

6.68           The Committee noted the large number of private Rulings issued annually.<sup>36</sup> While a private Ruling is binding against the Commissioner of Taxation in respect of the taxpayer who seeks its issue, the advice provided to the individual taxpayer has relevance to all other taxpayers in so far as the principles of taxation law, applied to the circumstances of one taxpayer, may be applied to all others.

6.69           The Committee further noted widespread support for access to private Rulings and concluded that all private Rulings should be publicly released in a format which does not identify the individual taxpayer but makes available to all taxpayers and all officers of the ATO, the ATO's advice upon the application of the law in certain factual circumstances. The Committee notes that such a system would require the development of a comprehensive computer database and information management system; a facility taxpayers and their representatives have long sought.<sup>37</sup> While acknowledging the cost of such a system, the Committee considers the value in improved consistency of advice and broader information dissemination warrants the outlay.

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35.   *Taxation Administration Act 1953*, ss.14ZAF, 14ZAG.

36.   See paragraph 6.81.

37.   Evidence, vol. 2, p. S171; vol. 3, p. S483.

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...and legal interpretation.

...  
... pp. 1545-67.  
... 3, pp. S384-5; vol. 7, p. S1072.

6.74 In addition, the Committee considered that the Rulings program should not be used by taxpayers as a source of free legal advice concerning highly speculative or hypothetical circumstances.<sup>40</sup> Such advice was available from commercial advisers and so long as the private Ruling's status was only that of an interpretation, the Committee considered significant Rulings on hypothetical circumstances should only be provided in association with a commercial charge. The Committee noted the Commissioner's discretion to refuse to deal with an application for a private Ruling where:

... in the opinion of the Commissioner, it would be unreasonable to comply, or continue to attempt to comply, having regard to:

- (i) the extent of the Commissioner's resources that would be required to comply; ...<sup>41</sup>

6.75 Given that the resources devoted to handling a large number of hypothetical Rulings could be significant, the Committee considered an appropriate alternative to the procedure detailed above would be for the Commissioner to seek to fund the necessary resources through a charge. The Commissioner would need to provide a quote to the taxpayer for the provision of advice based on reasonable charges for the use of resources and allow the taxpayer to determine whether they wished to pursue their Ruling request.

6.76 The Committee noted the evidence of the Commissioner to the effect that to date the ATO had not had occasion to deny a private Ruling request on the basis of a lack of resources.<sup>42</sup> The Committee considered that such an occasion would need to be highly exceptional and that only in the very rarest circumstance should the Commissioner exercise the discretion to refuse to deal with a request for a Ruling due to insufficient resources. Nevertheless, the Committee concludes that in that very exceptional circumstance it would be appropriate for the Commissioner to provide the Ruling for a charge. The Committee notes that any abuse of this discretion by the Commissioner would be capable of challenge in the Federal Court under the *Administrative Decisions (Judicial Review) Act 1977*.

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40. Evidence, vol. 5, p. S688.

41. *Taxation Administration Act 1953*, s.14ZAN.

42. Evidence, vol. 5, p. 1601.

6.77

**The Committee recommends that:**

**the Australian Taxation Office have the discretion to charge for the provision of private Rulings on significant hypothetical issues where under Section 14ZAN of the *Taxation Administration Act 1953*, the Commissioner of Taxation would otherwise determine that insufficient resources existed to provide the requested Ruling.**

## **Determinations**

6.78 The Committee noted general support given by taxpayers to the issuance of Determinations as a means of rapidly ascertaining the view of the Commissioner on a particular point.<sup>43</sup> However, the Committee was concerned at the possible use of Determinations as substitutes for fully reasoned Rulings. Given the importance of the ATO issuing advice as soon as practicable and balanced with the time taken to properly determine the issues in any given taxation circumstance, the Committee considered the greater dissemination of Determinations was preferable to the provision of no information at all. To the extent that Determinations provide a degree of certainty to the taxpayer, at least in so far as they may indicate the path for an audit or the likely thinking of the ATO generally, the Committee considered the ATO should continue to expedite their preparation and release.

6.79 In the Committee's view, the onus lies with the ATO to support Determinations with reasons and thus to convert Determinations to public Rulings. In the same manner as the Committee has recommended for private Rulings, it considers it inequitable to penalise taxpayers with culpability penalties for adopting a position contrary to a Determination when the Determination is merely the ATO's interpretation.

6.80

**The Committee recommends that:**

**culpability penalties not apply to taxpayers who fail in their assessment to follow a Determination issued by the Australian Taxation Office.**

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43. Evidence, vol. 4, p. S994; vol. 1, pp. 194, 222; vol. 2, pp. 446, 448; vol. 3, p. 650.

## Rulings and Legislative Change

6.81 In evidence to the Committee, the growth in the number of Rulings was highlighted. The Senate Standing Committee on Legal and Constitutional Affairs' 1987 Report, noted that in the period to the end of October 1987 there had been 700 income tax Rulings issued.<sup>44</sup> More recent evidence from the ATO indicated that by May 1992, 1 100 public Rulings had been issued along with 60 Capital Gains Tax Determinations and 53 taxation Determinations. In addition, during 1991-92, the ATO had received in excess of 50 000 requests for private Rulings while 55 000 private Rulings were issued.<sup>45</sup> Furthermore, the ATO advised that between 1 July 1992 and 30 June 1993, 290 taxation Determinations and public Rulings had been issued.<sup>46</sup>

6.82 The Committee considered that the number of pieces of advice issued indicated a fundamental problem in the legislative base and accordingly has made a number of recommendations in Chapter 5 in respect of the need for immediate legislative change.

6.83 The Committee noted the current use of Taxation Laws Amendment Bills for the purposes of making minor technical amendments to the law. The Committee considers this practice to be valuable and one which should be continued. In addition, the Committee notes the proposal for an Annual Tax Technical Corrections Bill.<sup>47</sup> Such a Bill would facilitate the legislative correction of minor, non controversial amendments to the law as well as the amendment of specific provisions to remove unwanted consequences. Also, it would be possible to incorporate in such a Bill, the substance of issued public Rulings which are considered to have clarified the law. In this way a progressive simplification of the taxation Acts would be effected.

6.84 **Consequently, the Committee recommends that:**

**there be an annual Taxation Clarification and Technical Corrections Bill to facilitate the simplification and technical correction of the *Income Tax Assessment Act 1936* and associated legislation.**

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44. Senate Standing Committee on Legal and Constitutional Affairs, *Income Taxation Rulings*, AGPS, Canberra, November 1987, p. 3.

45. Evidence, vol. 16, p. S3213.

46. Evidence, vol. 22, p. S5145.

47. Evidence, vol. 7, p. S1075.

## Consistency of Rulings

6.85 The Committee was concerned at evidence which suggested that both private and public Rulings had been issued which were inconsistent.<sup>48</sup> The Committee was presented with evidence that it was possible to 'shop' for a favourable Ruling, by seeking the Ruling from a particular branch office of the ATO.<sup>49</sup> The ATO claimed that consistency of Rulings was a key objective within the ATO<sup>50</sup> and that consistency was achieved through:

- . consistent skilling of technical officers;
- . communication between technical officers and skill sharing;
- . greater dedication of senior staff to the resolution of technical issues;
- . development of specialist cells; and
- . the development of the Information and Research Services (IRiS) project.

6.86 The Committee was concerned at the degree to which the systems for achieving consistency relied upon ad hoc communication between officers of the ATO, particularly given the organisation's devolved administrative network. The Committee noted the support for the specialist cell concept from taxpayer representatives and the quality of Rulings produced by these cells.<sup>51</sup>

6.87 The Committee also considered the development of the IRiS project. The first stage of this project was implemented during the Committee's hearings and was designed to provide a tax technical database and communication facility for technical staff. Through the provision of a single information network, the ATO anticipated that consistency and accuracy would be promoted. While supporting the development of a universal database, the Committee had some concern about the continued reliance upon voluntary officer participation in the system. In the Committee's view, the information database and communication system should be extensively utilised and officers required to access and participate to the fullest

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48. Evidence, vol. 4, pp. S640, S850.

49. Evidence, vol. 4, p. S688.

50. Evidence, vol. 4, p. S993.

51. Evidence, vol. 4, p. S746.

extent possible in the network. The Committee noted the ATO's claim of increasing usage amongst officers.<sup>52</sup> It was a situation which, in the Committee's view, needed to be closely and continually monitored.

## **Timeliness**

6.88 The Committee noted the importance of Rulings being issued in a timely manner and the identification of this factor by witnesses as a critical element in the efficiency of the taxation system.<sup>53</sup> Significant problems are faced by commercial taxpayers in particular when Rulings cannot be efficiently issued.<sup>54</sup> Evidence of long delays in receiving Rulings, particularly private Rulings, demonstrated to the Committee a serious and potentially critical weakness in the Rulings program.<sup>55</sup>

6.89 In the Committee's opinion, the increasing demand for both public and private Rulings, indicates a fundamental shift in the importance of Rulings to the taxpayer. The need for certainty in the self assessment system has meant taxpayers are not prepared to adopt positions when the taxation consequences are uncertain. While this degree of taxpayer caution can be considered positive it has resulted in increased demand for ATO instruction.

6.90 The Committee believes that some degree of rationalisation within the Rulings program is necessary together with a comprehensive review of the resources devoted to the Rulings program. Evidence presented to the Committee suggested that the current level of resources devoted to the Rulings program is inadequate.<sup>56</sup> The Committee has noted the ATO's efforts to increase the level of staff dedicated to this program.

## **Prospective v Retrospective**

6.91 The problem encountered by taxpayers where interpretation by the ATO changes over time was also considered by the Committee. The Committee noted the terms of Income Tax Ruling 2500 and the submissions by taxpayer representatives and industry professionals which argued that all Rulings should be

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52. Evidence, vol. 18, p. S4138.

53. Evidence, vol. 4, pp. S687, S745.

54. Evidence, vol. 4, pp. S709, S849.

55. Evidence, vol. 4, p. S745.

56. Evidence, vol. 4, pp. S623, S689, S745, S851.

prospective.<sup>57</sup> As interpretations of the law, Rulings of themselves neither create nor extinguish rights. Rather, as administrative instruments they indicate the intention of the ATO to assess obligations in a particular manner. The Committee considered that, in general, as statements of intent, Rulings should only be issued with prospective force and where one Ruling overturned another, the ATO should be obliged to give Rulings prospective application only.

6.92 With respect to private Rulings, the Committee considered taxpayers should be able to rely upon the advice provided by the ATO. If a private Ruling or a public Ruling retrospectively overturned a prior private Ruling, a taxpayer should be allowed to rely upon the prior Ruling, for those assessments prior to the issue of the contrary Ruling. The Committee considered that if, in reliance upon a Ruling, a taxpayer had established his or her affairs in a manner consistent with the Ruling, they should be assessed on the basis of that Ruling up until notification of the change in advice and should be allowed a reasonable period to restructure their affairs. Reasonableness in this context should be an administratively determined period of no less than two income years.

6.93 The Committee considers that the ATO has caused financial hardship and unnecessary inconvenience to taxpayers through the release of private Rulings which have later been overturned.<sup>58</sup> In the Committee's opinion, such circumstances should only ever result from deliberate legislative change and not administrative action.

6.94 The more reasonable approach envisaged by the Committee would put an onus on the ATO to provide clear, well reasoned and consistent advice. Professional standards dictate that the ATO, as a body holding itself out to the public as a reliable source of information, should be responsible for the information it provides to taxpayers.

6.95 With respect of the liability of the ATO for advice which may cause damage or loss to taxpayers where the advice is later overturned, the Committee notes taxpayers have a number of avenues of recourse against the ATO.<sup>59</sup> The Committee considers the administrative application of a consistent policy of prospective Rulings should avoid a majority of the potential claims for compensation.

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57. Evidence, vol. 4, p. S744.

58. Evidence, vol. 7, p. S1082; vol. 5, p. 1554.

59. Evidence, vol. 16, p. S3243.

## Obsolete Rulings

6.96 Evidence presented to the Committee highlighted the importance of reviewing and updating public Rulings and providing to taxpayers who assess on the basis of private Rulings, notification of changes in the law which may affect their obligation.<sup>60</sup> The development of a comprehensive Rulings database should allow such a notification process to be developed. Where a taxpayer has assessed on the basis of a private Ruling and a subsequent public Ruling, or contrary private Ruling, has been issued to them, the Committee considered it appropriate that no financial disadvantage should be borne by the taxpayer in the absence of advice from the ATO in respect of the change in the Ruling.

6.97 The Committee concludes that the ATO should, as a matter of priority, seek to review its current issued Rulings and Determinations databases to determine the continued relevancy of all Rulings. The ATO should furthermore inform taxpayers of the outcome of such a review and seek to group Rulings and Determinations in a co-ordinated and structured manner to facilitate taxpayer access to this information.

6.98 **The Committee recommends that:**

**the Australian Taxation Office review its issued private and public Rulings and Determinations for the purposes of determining the continued validity of all Rulings; and**

**all private and public Rulings and Determinations of the Australian Taxation Office be consolidated and referenced in a form which facilitates easy access by taxpayers.**

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60. Evidence, vol. 4, p. S743.



## Chapter 7

### MODERNISATION

- . Introduction
- . Background
- . Systems Re-equipment and Redevelopment
- . Electronic Lodgement Service
- . Automatic Data Capture
- . Decentralisation
- . Role of Staff in Modernisation
- . Specialist Cells
- . Modernisation Agreements
- . Modernisation - The Future

#### Introduction

7.1 A definition of the Australian Taxation Office's (ATO) program of modernisation is most difficult to ascertain without a full description of the process of on-going reform within the ATO aimed at producing an organisation which is relevant to an ever changing economy and society. Modernisation, or the process of becoming modern, cannot simply be considered as an investment in computer equipment and new office accommodation. During its Inquiry, the Committee was cognisant of the extent to which modernisation involved the evaluation of every element of the ATO's function and role.

7.2 As analysis of many of the elements of modernisation are contained in other chapters of this Report, it is not intended that those issues be revisited in this chapter. Nevertheless, the following brief description of the background to the decision to modernise unavoidably touches on some of those matters.

#### Background

7.3 It is difficult to know exactly what served as the catalyst for the modernisation program. Evidence from the ATO illustrated the grossly inadequate level of the information technology systems and staff accommodation which existed in the ATO in the 1970s and 1980s.<sup>1</sup> While the ATO was at the forefront of

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1. Evidence, vol. 4, p. S700.

computer processing in the early 1970s, it was absolutely clear that by 1985 the support facilities for ATO staff, both technological and otherwise, were inadequate for the efficient and productive performance of the functions of tax collecting.

7.4 Factors which were critical to the eventual decision to pursue modernisation included:

- . a significant increase in revenue collection functions as a result of an immense increase in the legislative base;
- . low staff morale following the tax avoidance scheme era;
- . static, process-driven work practices which featured highly technical assessment controlled workplace structures;
- . old, non-functional work environments; and
- . fundamental reforms both within the ATO and the Australian Public Service.<sup>2</sup>

7.5 Following reports by the Auditor-General and the House of Representatives Standing Committee on Expenditure, which bluntly acknowledged weaknesses in the ATO's administration, the ATO acted to determine the cause of the malaise. The major problems identified related to the structure and organisation of the ATO rather than a lack of staff resources.

7.6 In 1986, the House of Representatives Standing Committee on Expenditure criticised the degree of repetitive, manual operation used by the ATO in much of its assessment work, despite developments in computerisation.<sup>3</sup> It is evident from the amount of planning and strategy development carried out in the ATO between 1984 and 1987, that by the middle of the 1980s the senior officers of the ATO<sup>4</sup> were aware of problems with the computer support facilities and the corporate direction to which the facilities were expected to respond.

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2. Joint Committee of Public Accounts Report 287, *Australian Taxation Office - Computer Systems Re-equipment and Redevelopment*, AGPS, Canberra, 1987.
  3. House of Representative Standing Committee on Expenditure, *A Taxing Problem, Review of Five Auditor-General's Efficiency Audit Reports into the Australian Taxation Office*, AGPS, Canberra, 1986.
  4. Evidence, vol. 3, pp. 759-62.

7.7 In February 1987, Cabinet gave in-principle approval for a major staged computer systems re-equipment and redevelopment project in the ATO. The project was referred by the Treasurer to the Joint Committee of Public Accounts for evaluation and report, in accordance with the then standing reference. The findings of the Committee were presented in its Report No. 287.<sup>5</sup> The Committee made 12 recommendations concerning the proposal and in the preface to the Report stated:

The Committee ... is firmly of the view that the Taxation Office has no real alternative but to proceed with its computer systems re-equipment and redevelopment proposal.<sup>6</sup>

7.8 Notwithstanding its support for the re-equipment and redevelopment proposal, the Committee expressed concern at the ATO's capacity to manage a project of the size envisaged from within its staff resources. Moreover, the Committee concluded that the ATO needed to do a great deal more planning and evaluation of its strategies and resources prior to the commencement of the program.

7.9 In the formal Government response to the Committee's Report, the ATO disagreed with only one of the Committee's recommendations. This recommendation related to the need to establish a task force dedicated to the program and managed by experienced external resources. The ATO acknowledged the need to focus on technology as a tool to achieve the ATO's corporate objectives, but rejected the need to pass control of the management of the project over to external sources. Instead, the ATO established a team, led by a Second Commissioner and supported by an external consultant, to co-ordinate the many projects within the overall program.<sup>7</sup>

7.10 In considering the modernisation program, the Committee focussed on four aspects:

- . systems re-equipment and redevelopment;
- . accommodation;

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5. Joint Committee of Public Accounts, op. cit.

6. *ibid.*, p. v.

7. Joint Committee of Public Accounts, Report 301, *Finance Minutes*, AGPS, Canberra, 1989.

- . people; and
- . funding and resources.

7.11 During the course of the Inquiry the Committee was aware of a published review of the modernisation program conducted by Dr John Mathews of the University of New South Wales.<sup>8</sup> While Dr Mathews' study primarily evaluated the program from the aspect of organisational analysis and innovation, the Committee found the work to be a useful explanation of the program's scope and a valuable analysis of many of the program's projects.

## Systems Re-equipment and Redevelopment

7.12 At the time of the Committee's consideration of the re-equipment and redevelopment project in 1987, the estimated cost was \$693 million over twelve years.

7.13 The scope of the modernisation of the ATO's computer systems, together with a description of their gradual and staged development, was outlined in the ATO's submission to the Committee.<sup>9</sup>

7.14 From the earliest period of modernisation, conversion of existing business systems to a new technical platform was assigned a high priority.<sup>10</sup> This conversion was carried out as a separate project to the re-equipment program and involved the progressive conversion of systems on a controlled and discrete basis. This program was the subject of the Auditor-General's Report No. 29 of 1991-92. The Committee noted concerns raised about the extent of systems testing and the

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8. Mathews J, *The Australian Taxation Office: Modernisation Through People, Structures and Technology, Studies in Organisational Analysis and Innovation Number 6*, University of New South Wales, June 1992.

9. Evidence, vol. 6, p. S964.

10. Evidence, vol. 4, p. S762.

importance of maintaining control over the larger conversion projects. In concluding the Report, the Auditor-General stated:

The ANAO [Australian National Audit Office] concluded that the Conversion Project had achieved its primary aims for the systems already converted ... The ANAO considers that the project is well structured having commenced with the conversion of the simplest and smallest systems and then proceeding to the most difficult and complex.<sup>11</sup>

7.15 The main systems subject to conversion were:

- . Fringe Benefits Tax;
- . Pay-As-You-Earn;
- . Tax Agents Sub System;
- . Audit;
- . Prescribed Payments System; and
- . National Taxpayer System.

7.16 The purpose of the conversion project was to transfer each of the systems from the old computing platform to the new, without undertaking extensive redevelopment of the systems. The conversion project was necessary as the ATO selected and purchased Amdahl computers, using an IBM software environment, to replace its old system which it had initially purchased in 1973.

7.17 The purpose of the re-equipment project was to establish an information technology structure which would support the ATO's business activities and enable the goals and objectives of the modernisation program to be satisfied, within a specified timeframe.<sup>12</sup>

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11. Auditor-General, Audit Report No. 29 1991-92, *Project Audit: Australian Taxation Office Conversion of Automated Production Systems*, AGPS, Canberra, 1992, p. 3.

12. Evidence, vol. 4, p. S761.

7.18 The ATO established a coordinating contract to enable ATO management to work on a one-to-one basis with a single contractor. After an extended process the Computer Power Group was selected as the preferred contractor and a five year contract was signed and commenced in October 1989.

7.19 While the ATO progressively introduces new systems it is also eliminating older ones. To date upgrading of the central computer system has been achieved through successive 'releases', or projects, which progressively seek to replicate the final desired integrated system. At the same time existing systems have been converted to interact with the new systems. This procedure has been termed 'tacking', in that the process involves heading from one system development to an old system redevelopment.<sup>13</sup> Ultimately, the ATO hopes to establish a single collections system capable of managing all revenue lines for all functions through a single integrated on-line processing system. Through their computers, ATO staff will be able to access a full inventory of a taxpayer's affairs. All revenue lines and all possible functions will be linked.

7.20 As the development of the integrated system progresses, the ATO has also devoted considerable resources to the development of a number of what are termed 'front-end' projects. These developments, utilising current technological systems, have not affected the on-going systems development work of the ATO, but have obtained significant press and publicity due to their impact on taxpayers. Their development in advance of the major redevelopment projects was a deliberate choice by the ATO, designed to introduce the redevelopment work in the context of the low-profile business revenue lines.<sup>14</sup> The Committee devoted considerable attention to these projects:

- . the Electronic Lodgement Service;
- . Automated Document Dispatch;
- . Tax Local Area Network;
- . Automated Document Capture;
- . the use of Electronic Funds Transfer; and
- . the National Office Management Administration System.

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13. Mathews J, op. cit., p. 85.

14. *ibid.*, p. 94.

7.21 Furthermore, the Committee noted the development of computer assisted auditing and in particular, the use of computers in the selection of cases for audit and the use of portable computers for the collection and evaluation of data. The Committee acknowledged the use of computer information matching systems to replace manual checking of discrepancies between interest dividend income claimed and amounts paid. The further development of income matching computer facilities was identified as an integral component of the strategies for non-business individuals detailed in the Income Tax Compliance/Enforcement Strategy. This is discussed in Chapter 8.

## Electronic Lodgement Service

7.22 In essence, the Electronic Lodgement Service (ELS) involves the automation of the paper based returns processing system and the provision of a facility to allow tax agents to prepare and lodge their clients' tax returns electronically rather than through the submission of paper returns. Tax return information can be transmitted from computers in the agent's office directly to the ATO.

7.23 The ELS has been expanded from its original agent-based network to include keying-in of return information for disadvantaged taxpayers by ATO staff at enquiry counters and the use of networked terminals at non-agent service providers. The most well known of these is Australia Post, who have marketed the TaxPack Express (formerly FastTax) service. In 1993, for a \$20 fee, taxpayers can lodge returns through Australia Post centres and receive the same service standards as those lodging their returns through tax agents.

7.24 The Committee noted the significant resource savings the ELS has produced for the ATO through the elimination of the need for vast numbers of officers to key information into data bases. The benefit for the taxpayer has also been considerable, since turnaround times for taxation returns have been dramatically reduced. On the other hand, tax agents expressed the view that the benefits of the ELS have not yet flowed to their sphere.<sup>15</sup> In particular, the agents expressed the opinion that more efficiencies could be drawn out of the use of the computer equipment which they had been required to install to participate in the ELS. For example, on-line access to certain ATO systems other than the ELS, such as client listings and the legal information database, would provide further efficiency benefits to agents and ultimately to the ATO.<sup>16</sup>

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15. Evidence, vol. 6, p. S890; vol. 8, p. S1396; vol. 15, p. S2369.

16. Evidence, vol. 2, p. 571; vol. 3, p. S483.

7.25 Agents also considered there would be a benefit in the ATO providing official certification for the software used by the agents on their computers.<sup>17</sup> The Committee agreed that a certification procedure, which tested software and indicated its capacity to produce consistent results with sample data, would provide a protection to taxpayers in the case of a computer generated error. Current registration procedures, it was claimed, were too limited.<sup>18</sup> The Committee considered the arguments of the agents to be convincing, particularly given the ATO's capacity to influence computer software manufacturers in their development of supporting software for the ELS. Software errors, detected and recorded by a licensing code which appeared on returns generated by an approved software product, would entail no penalty for the taxpayer or agent. The ATO could then seek from the distributor or manufacturer, rectification of the error. The Committee recognised the limited degree of registration and certification currently provided by the ATO.<sup>19</sup> In the Committee's view the ATO could do more to assist agents in this area.

7.26 In addition, agents expressed concern about their legal position vis-a-vis the ATO and their clients in light of the move to an interim paperless system.<sup>20</sup> This feature was particularly commented upon by the Auditor-General in his Report No. 5 of 1992-93. With the move to an interim paperless system, the tax agent keeps the taxpayer's return, which effectively requires the tax agent to act as an agent of the ATO. By holding the return, the tax agent is therefore, in theory, part of the ATO. In the Committee's view, this theoretical outcome is unacceptable and should be rectified immediately. While the Committee recognises the need for registration of tax agents, with the ATO, it considers the relationship between the agent and ATO to be significantly different to the relationship between the agent and taxpayer. In the Committee's view this difference needs to be formally recognised.

7.27 In Audit Report No. 5 of 1992-93, the Auditor-General noted that the ELS had been a successful development for the ATO.<sup>21</sup> He did, however, make seven recommendations, including one relating to the need for definitive legal arrangements to support paperless processing to be in place as soon as possible.<sup>22</sup> The Committee agrees with the Auditor-General, and has concluded that the ATO should review all initiatives which have been developed as a result of either self

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17. Evidence, vol. 5, p. S706; vol. 5, p. S750.

18. Evidence, vol. 5, p. S706.

19. Senate Hansard, 28 May 1992, p. 3017.

20. Evidence, vol. 3, p. S483.

21. Auditor-General, Audit Report No. 5 1992-93, *Project Audit Australian Taxation Office, Electronic Lodgement Service*, AGPS, Canberra, 1992, p. viii.

22. Auditor-General, Audit Report No. 5, 1992-93 *Project Audit: Australian Taxation Office Electronic Lodgement Service*, AGPS, Canberra, 1992.

assessment or modernisation to ensure a legislative framework existed in the law to support those developments.

7.28 The ATO considers that the ELS has been one of its success stories.<sup>23</sup> To the extent that the system has been utilised by a far larger number of people than was originally estimated, processing costs for returns have been substantially reduced and the participation of tax agents has been far greater than expected. The ELS has proved to be, at the very least, popular and efficient, as was acknowledged by the Gold Award in the 1990 Government Technology and Productivity Awards presented to the ATO for the ELS.<sup>24</sup>

7.29 Nevertheless, the Committee considered greater productive use could be made of the computer technology associated with the ELS. The Committee noted a suggestion by the Nation Director of the Australian Taxpayers Association that the ATO pay agents for their use of the ELS.<sup>25</sup> Given the largest efficiency gains from the system clearly rest with the ATO, the Committee considers such a proposition to be valid in the absence of an active commitment on the ATO's behalf to supporting agents. Furthermore, the Committee concludes that the service fee for taxpayers who lodge through the ELS should be paid by the ATO as the principal economic beneficiary.

7.30 **The Committee therefore recommends that:**

- . **the relationship between tax agents and the Australian Taxation Office be clarified, so that no agency relationship can be construed to exist between the tax agent and the Australian Taxation Office;**
- . **the Australian Taxation Office review the legislative framework supporting all initiatives arising out of both modernisation and self assessment;**
- . **the Australian Taxation Office establish, in consultation with the accounting profession and the computer software industry, an Electronic Lodgement Service audit and support unit for the purposes of testing and certifying software produced for use on the Electronic Lodgement Service;**

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23. Evidence, vol. 4, p. S950.

24. Commissioner of Taxation, *Annual Report 1990-91*, AGPS, Canberra, 1991, p. 8.

25. Evidence, vol. 1, p. 183.

Electronic Lodgement Service generated returns indicate whether the return was processed using a certified computer software program;

the Australian Taxation Office seek to develop, as part of its business systems, facilities for the access of tax agents and others to a number of databases of the Australian Taxation Office, in particular the client listings database and the legal information system database; and

where a taxpayer lodges a return through an Electronic Lodgement Service terminal, the Australian Taxation Office pay the requisite service fee in recognition of the economic benefit it derives.

### **Automated Document Dispatch**

7.31 The Automated Document Dispatch system automates the printing and despatching of notices and is linked to all branch offices of the ATO via modern output printing and dispatch equipment. Evidence to the Committee was that the system, which was implemented in July 1991, was currently issuing in excess of 70 000 notices per day.<sup>26</sup>

7.32 The development of this system has required a degree of rationalisation and redesign in the ATO forms, notices and correspondence. Cost savings have been achieved as a result of the system's introduction, principally through reduced postage and stationery costs. The inability of the ATO to quantify those savings was of concern to the Committee. One witness, who estimated the savings as high as \$80 million over ten years, praised the system for producing more 'user friendly' assessments.<sup>27</sup>

7.33 The Committee identified some concerns with the Automated Document Dispatch, not least of which was the impact which officious notices have on certain taxpayers in the community, such as the elderly and those who know very little about the law. The Committee recognised these difficulties derived from the use of a general production system which could not easily separate taxpayer groups. However, in the Committee's view, notices need to be more sensitive in their wording, having regard to the impact their receipt may have on those in a disadvantaged or vulnerable circumstance. The Committee noted evidence of the

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26. Evidence, vol. 6, p. S952.

27. Evidence, vol. 12, p. S2366.

impact of an unwarranted, officious letter and believes it is imperative that the ATO be aware of the impact of automatically generated, standard form material and seek, wherever possible, to consider the taxpayer's circumstances in their initial correspondence.<sup>28</sup>

7.34 The automatic production of forms, particularly final notices and penalty notices, was noted by the Committee as an area of concern to taxpayers and their representatives. Automatic form production may result in unwarranted notices being sent to taxpayers as a result of inefficiencies elsewhere in the system.<sup>29</sup> The Committee concluded that the responsibility for checking the accuracy of correspondence rested at all times with the ATO.

7.35 Privacy and security concerns, stemming from the use of database technology were also noted by the Committee. The Committee acknowledged the existence of a dedicated Privacy Unit within the ATO which was in regular contact with the Privacy Commissioner's Office on matters of importance.<sup>30</sup> The Committee urges the ATO to vigorously monitor and review all computer programs and database security for possible privacy breaches.

### **Tax Local Area Network**

7.36 Tax Local Area Network (TaxLAN) is a facility which provides ATO staff with the opportunity to access mainframe applications (subject to security and privacy considerations), to increase personal productivity and improve internal communications from a single point of access. During the inspection, of the ATO's Parramatta branch office on 13 May 1992, Committee members were given a demonstration of the potential of the TaxLAN system. Over 11 000 work stations have been progressively installed in the ATO since 1989, providing one of the largest local area networks operating.<sup>31</sup>

7.37 The Committee was given evidence of the potential for the network as a communication facility and the degree to which the TaxLAN was improving the productivity of employees, although this was not quantified.<sup>32</sup> Future applications of the system, particularly for single point access to full taxpayer information and the development of an Integrated Payment and Service System from which taxpayers can receive comprehensive advice, was considered by the Committee to

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28. Evidence, vol. 1, p. S55.

29. Evidence, vol. 3, p. S482.

30. Evidence, vol. 16, p. S3253.

31. Evidence, vol. 6, p. S957.

32. Evidence, vol. 6, p. S949.

offer significant opportunities for improved efficiency and service delivery by the ATO. Unfortunately, during the Committee's inspection of the Parramatta branch office, the ATO was unable to demonstrate the full capacity of TaxLAN. The Committee was concerned at the possible loss of processing capacity which may result from faults in the basic system programs. Nevertheless, the Committee recognised the importance of TaxLAN to the full utilisation of the collection management system.

7.38 A major weakness identified by the Committee was the potential for system delays and downtime in the network as more officers were added to the system. Such a weakness must raise serious questions about the planning of the project, the system itself and its implications for the taxation system in general. The Committee noted the work being done by the ATO to monitor these issues and concluded that the ATO should expedite a strategic analysis of the potential risks and efficiency losses that may result from various load factors in the system and develop appropriate response strategies.

7.39 The Committee further noted the training and support facilities available to system users and recognised that such training will be of on-going significance to the TaxLAN system.

7.40 Given the sizeable investment in personal computer facilities, the Committee has concluded that the ATO should implement programs to assist all staff to maximise the facilities of TaxLAN. The Committee is concerned that certain staff may be intimidated by the technology and therefore fail to maximise its potential, despite extensive training. The Committee also concludes that the ATO should conduct surveys of computer usage by each organisational group to determine the relative efficiencies and effectiveness of TaxLAN across the ATO and that appropriate action should be taken where usage indicates a failure to maximise productivity.

7.41 **The Committee recommends that:**

**the Australian Taxation Office monitor and evaluate the relative use of TaxLAN facilities throughout its organisational Groups and develop programs to facilitate the productive utilisation of TaxLAN's functionality.**

## Automated Data Capture

7.42 Information received by the ATO comes in many forms. To the extent that information can be processed and interrogated by electronic means, the most efficient format for the information received is that which is computer transferable. The ELS provides a good example of the efficiency of computer transmitted material. The Billpay service, by which tax debts may be paid through Australia Post, is also an example of a service which further removes the taxpayer from the ATO. The Committee noted however, possible limitations on the Billpay service in the case of small post offices which may not be prepared to accept large sums of money for security reasons.<sup>33</sup> Such difficulties can create inequity in the service afforded to different taxpayers.

7.43 The Committee noted the ATO's intention to continue examination of options for expanding Billpay into the banking system.<sup>34</sup> The use of Electronic Funds Transfer was also considered by the Committee. The implementation of such a system would provide the ATO with the opportunity for better cash management and therefore the generation of administrative savings for the Commonwealth. Improved service to taxpayers was also considered to be a major advantage. The co-operation of the finance industry will be crucial to the widespread use of Electronic Funds Transfer.

7.44 As long as taxpayers are required to lodge information with the ATO in a *hardcopy form*, a *dual system of administration* will be necessary. A cost to the taxation system in the dual handling of papers is thus incurred. Utilisation of Optical Character Recognition technology has the potential to allow computer storage and thereby reduce costs of both storage and handling. The ATO has recently commenced an examination of the value of such technology.<sup>35</sup>

7.45 The programs listed above are all being developed through a modernisation project entitled Automated Data Capture. The Committee concludes that such a project presented the potential for administrative convenience and savings, for both the ATO and taxpayers. However, an obligation exists for the ATO to ensure that the benefits of such programs are equally distributed between all taxpayers regardless of their location. Service flexibility should be considered whenever a new service is developed.

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33. Evidence, vol. 5, pp. 1447-48.

34. Evidence, vol. 5, p. 1448.

35. Evidence, vol. 18, p. S4143.

## National Office Management Administration System

7.46 The National Office Management Administration System (NOMAD) a computerised personnel system is widely used in the Australian Public Service. The ATO commenced using the NOMAD system in January 1992 and, as a first priority, migrated essential personnel entitlement data to the new system. Previously, all staff information was maintained on a card system.<sup>36</sup>

7.47 In the course of the Inquiry, the Committee had cause to investigate the capacity of the ATO's personnel information system to produce basic staff information.<sup>37</sup> The Committee was disturbed to discover the extent of the inadequacy of the personnel record system. So unsatisfactory was the system that the Committee could only conclude that any information the ATO could produce about its personnel, prior to 1992, would be at best incomplete and at worst misleading. The Committee was left with the impression that the ATO had been administered, until 1992, without appropriate or adequate information about its single most important asset and resource - its staff.

7.48 The Committee recognises the potential for future management information stemming from the NOMAD system. However, the value of that information for personnel planning will be severely limited until such time as staff histories are recorded in the system. The Committee was informed by the ATO that such a migration has a low priority.<sup>38</sup>

7.49 The Committee is concerned that the failure to proceed with some haste to complete the NOMAD system, including staff histories, will mean that personnel resource decisions will need to be based on individual perceptions and value judgements rather than any factual evidence. Succession planning, for example, will be impossible for the ATO, except at the very narrowest level, until information regarding serving officers' careers is incorporated on the database. The Committee concludes that such an outcome is unsatisfactory.

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36. Evidence, vol. 3, p. 944.

37. Evidence, vol. 3, p. 943.

38. Evidence, vol. 3, p. 945.

7.50

**The Committee recommends that:**

- . **the Australian Taxation Office increase the priority within the modernisation system of the migration of information onto the National Office Management Administration System; and**
- . **information on the National Office Management Administration System be fully utilised for human resource management reporting and planning.**

## **Decentralisation**

7.51 In evidence the ATO expressed the view that a key element of its success and a key to the creation of platforms for future success has been the program of decentralisation of ATO staff into branch offices of a 'more manageable kind'.<sup>39</sup>

7.52 Factors influencing the move towards decentralised accommodation for the ATO included:

- . the historically poor condition of ATO accommodation;
- . dispersed and fragmented siting of office accommodation;
- . unacceptably large ATO branch offices; and
- . the need to establish accommodation suited to the structures and priorities of the modernisation program.

7.53 As a consequence of historical ambivalence, the ATO had been expected to perform its critical revenue raising function in accommodation which could be described as having a Dickensian ambience. Buildings without adequate electric power and airconditioning, housed staff numbers which were by any measure unmanageable.<sup>40</sup> Moreover, staff were often accommodated in dispersed sites with inadequate communication links. The capacity to draw staff towards a corporate culture of service to taxpayers was thus severely limited.

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39. Evidence, vol. 4, p. S736.

40. Evidence, vol. 4, p. S737.

7.54 A precursor to the decentralisation program was the establishment of a branch office in Parramatta in 1975. The next seven years witnessed little if any progress in the decentralisation program primarily as a result of general Public Service-wide resource cutbacks and restrictions. By October 1993, the ATO operated out of 24 branch offices, as well as the national office in Canberra. A full listing of the ATO's branch offices is at Appendix 6.

7.55 Decentralisation offers many benefits to the ATO including:

- . better accommodation and improved staff morale;
- . the opportunity to base offices near the taxpayer base;
- . better access for officers to their home environment as many officers are able to live nearer their work place; and
- . a greater focus on client needs and improved client liaison.

7.56 The target office staffing level was set in the range of 600-800 staff although smaller regional offices have been created to service country communities. The target was considered to provide economies of scale in operations and varied career opportunities for staff.<sup>41</sup> Branch specialisation was retained on the basis that certain branches were located in areas where the taxpayer population had specific demands, such as a relatively large number of small businesses. Factors considered in the determination of where a branch office would be located were included in evidence to the Committee.<sup>42</sup>

7.57 Concerns were expressed, particularly by business taxpayers, about the level of service some branch offices were able to provide and the capacity of decentralised offices to accept responsibility for technical decisions on a day to day basis.<sup>43</sup> The Committee considered these problems derived not so much from the operation of smaller, decentralised offices but rather from the work flow structures that had developed in line with the devolution of responsibilities from the national office and the procedural steps in respect of decision making, which applied particularly in the area of audit.

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41. Evidence, vol. 4, p. S739; vol. 7, p. S1074.

42. Evidence, vol. 17, p. S3524.

43. Evidence, vol. 3, p. S473; vol. 3, p. S484.

7.58 The Committee agreed it would not be administratively sensible to establish a large number of small scale offices around Australia which were required to perform all the ATO's functions. However, each branch office must have the capacity to service all taxpayers who utilise its facilities in an equally efficient manner whether through direct assistance or by seeking, on the taxpayer's behalf, the assistance of another office. The Committee considered the basis upon which decisions in respect of the siting of new branch offices were made by the ATO.<sup>44</sup>

7.59 The Committee recognised that branch offices need not be mirror images of each other. However, as taxpayer problems and compliance issues are often common across certain broad classifications, each branch office needs to be resourced in a manner which promotes the ATO's corporate goals, particularly, service to taxpayers. Thus all branch offices must have the capacity to provide advice, information and audit facilities to an equal standard but in proportion to the taxpayer base it services. In this respect, the Committee considered the ATO should introduce a standard 008 telephone service for taxpayer enquiries. In the Committee's opinion the taxation system would benefit from a shift in the cost burden of advising. This issue is discussed more fully in Chapter 10.

7.60 The Committee heard evidence from a number of witnesses about the loss or disbursement of technical skill as a consequence of decentralisation.<sup>45</sup> It was argued that the need to break up formerly efficient audit and revenue collection teams to ensure all branch offices had a minimum skill level was a regrettable consequence of decentralisation. The ATO informed the Committee that it considered the consequences of this disbursement of talent had been minimised and would, in the longer term, prove a positive factor in the development of more broadly based skills. The ATO indicated that while it understood the argument, it did not consider the matter to be as serious as some would make out.<sup>46</sup>

7.61 The Committee could not assess the relative skill levels of individual branch offices. Nevertheless, the Committee urged the ATO to remain alert to suggestions of skill shortages and where necessary seek to retain efficient technical work groups, which had demonstrated a capacity to produce results in specialised fields. The expansion of computerised databases and communication facilities should permit the greater distribution of technical information and require fewer officer transfers. Comments on the financial aspects of the decentralisation program are contained in Chapter 8.

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44. Evidence, vol. 17, p. S3524.

45. Evidence, vol. 3, p. 668; vol. 3, p. 724; vol. 3, p. 893-4.

46. Evidence, vol. 4, p. S741.

7.62 The Committee concluded that decentralisation had been generally well managed although insufficient attention had been given to the consequences of staff disbursement and the break-up of specialised groups.

### **Role of Staff in Modernisation**

7.63 The integral role that the staff of the ATO have played, and will continue to play, in the successful implementation of all aspects of the modernisation program was recognised by the Committee in 1987.<sup>47</sup> The adaptability of staff to changing work environments and their capacity to alter long standing work practices to achieve increased efficiencies has been crucial to the on-going development of the ATO's administration.

7.64 The Committee recognises and congratulates the staff of the ATO for their efforts to date, particularly their willingness to participate in job redesign projects and to facilitate those procedures. The Committee considered the success of future developments and processes will continue to depend upon the involvement of all staff.

7.65 The Committee was especially impressed with the role staff have played in the restructuring of the processing and revenue collection functions. The Committee considers it imperative that the ATO continue to examine and justify all aspects of its operational methods. The development of a professional, technically advanced workforce at all levels will be an essential ingredient for the future efficiency of the ATO. To this end the Committee notes and endorses the general tenor of the ATO's Corporate Plan for 1992-1995.

### **Specialist Cells**

7.66 One significant aspect of staff reorganisation which derived from modernisation and decentralisation was the development of specialist cells. These cells were initially created to provide services to specific taxpayer groups in respect of complex interpretations of the law. They also acted as a conduit between the ATO and the taxpayer and served to reduce the level of disputes by representing the best technical view of the ATO on a given subject.

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47. Joint Committee of Public Accounts, Report 287, *Australian Taxation Office - Computer Systems Re-equipment and Redevelopment*, AGPS, Canberra, 1987, p. 13.

7.67 Each cell consists of a team of skilled technical staff with expert knowledge on a particular subject or industry. Members have been drawn from branch offices throughout Australia. In a sense, the specialist cells are the offspring of the decentralised office in that the cells act to draw together resources which had otherwise been disbursed by the establishment of new offices. The Committee noted that, to date, the ATO had not sought to establish specialist cells in a single location. Consequently, the cells operate like committees linked by telecommunications and occasional meetings.

7.68 Evidence from taxpayer representatives strongly supported the continued development of specialist cells.<sup>48</sup> The advantage of access to specialists in a particular field and the capacity to obtain advice or Rulings in a certain and efficient manner were considered to be the strongest arguments in support of the cells. Nevertheless, the Committee recognised that the cells were primarily an internal resource for the ATO. One representative of taxpayers, in evidence to the Committee, questioned the skill and seniority of officers in cells as contrasted to senior ATO staff in Canberra.<sup>49</sup> This issue was considered by the Committee and, on the evidence presented by the ATO, the Committee concluded there was genuine senior officer support in the national office for the specialist cells. In particular, the ATO's intention to extend the technical specialist cell network was considered to be evidence of the full integration of the cells within the management of the ATO.<sup>50</sup>

7.69 Specialist cells have now been created with respect to:

- . Capital Gains Tax;
- . Insurance Industry;
- . Property Development Industry;
- . Banking and Financial Products;
- . Mining Industry;
- . Fringe Benefits Tax;

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48. Evidence, vol. 1, p. 223; vol. 7, p. S1066.

49. Evidence, vol. 2, p. 473. -

50. Evidence, vol. 22, p. S5301.

Public Infrastructure; and

Foreign Source Income.<sup>51</sup>

7.70 The Committee notes that if the specialist cells, particularly those likely to impact upon a significant number of taxpayers such as the Capital Gains Tax, Property Development and Fringe Benefits Tax cells, are to be fully effective in providing both technical support within the ATO and direct access to individual taxpayers, they need the full time commitment of staff members and appropriate technical and support resources.

7.71 **The Committee recommends that:**

**the specialist cells be provided with sufficient resources to enable them to have full time members and adequate technical and administrative support to provide both a service to officers within the Australian Taxation Office and a point of direct access for taxpayers.**

7.72 Decentralisation of the ATO's branch structure reflects in part the need of the ATO to integrate with the community it serves. While the Committee notes the necessity of the ATO to move to more appropriate accommodation, it is concerned that the ATO should ensure that the needs of taxpayers are always given primary consideration in the decision to decentralise and in the establishment of particular staffing profiles. In addition, the Committee is concerned that decentralised branch offices should be capable of responding to taxpayer requests in a consistent and efficient manner. The Committee notes the role that specialist cells have played in drawing together staff skills in a manner which is both productive and effective. The Committee urges the ATO to continue to develop access mechanisms for taxpayers to the specialist cells and ensure that the skill base of the cells is adequately conveyed to all relevant officers throughout Australia.

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51. Australian Taxation Office, *Draft Annual Report 1992-93 for Senate Estimates*, August 1993.

## Modernisation Agreements

### PSU Modernisation Agreement

7.73 At the time of consideration by the Committee, the Modernisation Agreement (the Agreement) was one of only five agreements ratified by the Industrial Relations Commission under s. 115 of the *Industrial Relations Act 1988*.<sup>52</sup> The Agreement is expressed as being between the Treasurer and the Commissioner of Taxation on the one hand and the Australian Public Sector and Broadcasting Union (PSU) on the other in respect of officers and employees of the ATO.

7.74 Compared to other s. 115 agreements, the ATO Agreement is clearly the most extensive negotiated under this section of the Industrial Relations Act. The Committee carefully considered the terms of the Agreement, particularly the many terms which established a major role for the PSU in the process of modernisation. The Committee was particularly concerned at the inclusion in the Agreement of clause 2.5 which required the Commissioner's statutory powers to be exercised subject to the terms of the Agreement. Evidence to the Committee indicated that such an outcome was not possible.<sup>53</sup> However, no alternative interpretation of the provision could be provided by the ATO.<sup>54</sup> The Committee concluded the provision was unenforceable and therefore redundant.

7.75 A costing of the Agreement was sought from the Department of Finance. An initial costing indicated that the provisions of the Agreement which provided a benefit to the PSU would have a direct cost to the ATO of approximately \$2.4 million over five years. A further costing provided by the Department of Finance, which made certain assumptions regarding the estimates of employee benefits available under the Agreement, determined the direct cost of the Agreement to possibly be as high as \$60 million over five years.<sup>55</sup> A paper presenting the benefits of the Agreement, from the ATO's perspective, was also submitted to the Committee.<sup>56</sup>

7.76 *The Agreement represents a blueprint for union involvement in the modernisation program. The Committee considers such an involvement to be important for the success of the process. In 1987, the Committee had cautioned the*

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52. Evidence, vol. 13, p. S2533.

53. Evidence, vol. 14, p. S2880.

54. Evidence, vol. 4, p. 1245.

55. Evidence, vol. 14, p. S2898.

56. Evidence, vol. 15, p. S3120.

ATO about the necessity of obtaining staff association support for the project. To the extent that industrial harmony has been maintained in the ATO during the period of modernisation, the Agreement could be considered to have been successful.

7.77 Given that both the ATO and the PSU have abided by the terms of the Agreement, the Committee concludes that the Agreement establishes a continuing basis for a genuine relationship between the ATO and staff unions in managing the processes of modernisation. Nevertheless, the Committee concludes that the efficiency of the PSU Agreement needs to be thoroughly evaluated as it sets a precedent for other organisations. The Committee considers the Auditor-General is best placed to conduct such an evaluation.

7.78 **The Committee recommends that:**

**the Auditor-General conduct an evaluation of the effect of the Public Sector Union Modernisation Agreement on the efficiency of the Australian Taxation Office.**

### **The Funding Agreement**

7.79 With the modernisation program spanning a 10-12 year period, the annual appropriation system of government funding posed a potential risk to the achievement of the program's success. Requiring the ATO to explain and justify each year its proposed modernisation expenditures, in the light of shifting budgetary constraints, would have presented the possibility that the program would have become financially fractured, and decisions made on other than commercial grounds. Moreover, the potential for management to respond to eventualities in a flexible manner would not have existed.

7.80 The Department of Finance therefore concluded, on behalf of the Government, a funding agreement with the ATO which guaranteed a fixed allocation of resources for the purposes of the modernisation program. This agreement provided both certainty and flexibility to the ATO. A guaranteed level of funding was established and arrangements implemented which allowed funds to be brought forward and carried between years. The arrangements included provisions which maintained the present value of the cost effectiveness of modernisation by providing adjustment factors to the transfer of funds between years.

7.81 The cost effectiveness ratio for modernisation was estimated at 1:1.49 over 12 years with all other factors remaining constant.<sup>57</sup> Budget funding of modernisation is due to cease in 1997-98 although expenditure of funds may occur after this time as individual projects are completed.

7.82 Apart from the guarantee of funding and innovative flexibility arrangements, the financial agreement contains two significant clauses to which the Committee's attention was drawn. Clause 6 of the agreement details the Modernisation Savings Dividend. Savings of 3 000 staff positions were calculated to reflect the appropriate return on the invested funds. In theory therefore, all other things being equal, it could have been anticipated that the ATO, would have an average staffing level (ASL) at the end of the Modernisation Project which was 3 000 less than what it was in 1989-90. An average salary figure was multiplied by the 3 000 positions to determine the salary savings to the Budget. This figure, together with an agreed estimate of savings in administrative expenses, was progressively deducted from the base allocations of the ATO commencing in 1989-90.<sup>58</sup> The following Table sets out the resource reductions arising from modernisation for the period 1993-94 to 1995-96.

**Table 7.1: Planned Reductions in the Running Costs Budget of the Australian Taxation Office Stemming From Modernisation  
1993-94 to 1995-96**

	1993-94	1994-95	1995-96
Salaries Reduction	\$19.3m	\$9.8m	\$4.7m
Total Budget Reduction	\$21.0m	\$10.7m	\$5.2m
ASL Reduction	750	400	90

Source: Evidence, vol. 15, p. S2975

7.83 The assumption of the status quo implicit in the calculation of staff savings was never expected to be mirrored in reality. Indeed, the ATO in its agreement with the PSU anticipated staff growth. This was clearly indicated by clause 5.3 of the Modernisation Agreement which capped the ASL in the ATO at 17 100. That is, the ATO was committed to the PSU to not allow staff numbers to fall below 17 100.

57. Evidence, vol. 14, p. S2828.

58. Evidence, vol. 2, p. 627.

7.84 The basis of the assumption upon which the ATO agreed with the Department of Finance to the 3 000 ASL saving are set out in Chapter 8. Suffice to say that economic conditions dramatically changed between the time the funding agreement was signed and the time of the Committee's hearings. This change impacted upon the total resources of the ATO in such a way as to significantly shift the balance in the ATO's running costs budget between salaries and administrative expenses. While the resources delivered up by the ATO as modernisation savings were withdrawn by the Department of Finance, evidence to the Committee indicated that the ATO was retaining its staff though a combination of budget allocations and financial rearrangements of its running costs. Such rearrangements were fully permissible within the rules for the use of running costs allocations. The implications of these arrangements are discussed in Chapter 8.

7.85 The total agreed funding base for the modernisation program in 1989-90 was \$1.16 billion. By 1991-92 that amount was valued at \$1.257 billion. This was due to the application of interest adjustments on allocations not spent in 1989-90 and 1990-91. On the basis of evidence presented to the Committee, Table 7.2 shows how the \$1.257 billion could be allocated.

**Table 7.2 - Modernisation Funding as at 1991-92**

Expenditure Categories	(\$ m)
Salaries	235.919
Administrative Expenses	282.643
Property Operating Expenses - Current	174.830
Property Operating Expenses - Capital	139.591
Plant and Equipment	393.848
Construction of Facilities	30.198

Source: Evidence, vol. 4, p. S966.

7.86 As the figures in Table 7.2 indicate, while the largest proportion of the funding was intended to be spent on the acquisition of computer facilities, a large slice of the funding was provided for the rental and fitout of new accommodation. The consequences of clause 5(vi) of the funding agreement are considered in Chapter 8.

## Modernisation - The Future

7.87 In evidence, the ATO announced that it had deferred by around four months the phased implementation of its Collection Systems Modernisation (CSM) project. As a consequence, the ATO was forced to defer for one year payment of \$7 million of the 1993-94 modernisation dividend,<sup>59</sup> representing 36% of the 1993-94 salary dividend. Such a deferment was anticipated by the terms of the modernisation funding agreement between the ATO and the Department of Finance.

7.88 CSM is at the heart of the modernisation strategy and involves a complex mix of system, organisational, job and work design changes within the ATO. The objective of CSM is ultimately the development of a 'one stop shop' service for businesses with responsibilities covering several revenue lines. Critically, CSM has a direct impact upon the work of 1 600 staff. These staff collect 80% of the revenue collected by the ATO.<sup>60</sup>

7.89 The ATO advised the Committee that the size and importance of the project required that it be implemented correctly and without undue haste. While the Committee fully appreciated and supported the sentiments expressed by the ATO, it was not able to determine the cause of the slippage in the program. The Committee will carefully monitor the ATO's introduction of this system.

7.90 The Committee is of the view that, in the time period before the introduction of the CSM project, the ATO should develop performance measures and targets for the project which take into account the revenue improvements and resource savings that can be expected to flow from such a major development. In the Committee's opinion, such measures and targets should be prepared for all new collection system developments and reported in the Commissioner's Annual Report.

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59. Evidence, vol. 18, p. S4142.

60. Evidence, vol. 18, p. S4142.

7.91

Therefore the Committee recommends that:

- . the Australian Taxation Office prepare estimates and targets for revenue gains, cost savings and performance standards expected from the implementation of the Collection Systems Modernisation project; and
- . the Australian Taxation Office report progress and performance against targets for the Collection Systems Modernisation project in the Commissioner's Annual Report.

7.92

The Committee recognises that the calculation of revenue increases and resource savings would involve a number of assumptions regarding the impact of the system's development in the face of other exogenous factors. However, such an estimate would provide substantial justification for the sizeable investment the Government has made in the modernisation project. Moreover, the development of service standards would facilitate community support for the investment in modernisation.

## Chapter 8

### RESOURCES

- . Running Costs
- . Human Resources
- . Administrative Expenses
- . Property
- . Legal Services
- . Other Services
- . The Efficiency Dividend
- . Income Tax Compliance/Enforcement Strategy
- . Projected Revenue Gains and Resource Requirements
- . The ATO and the Department of Finance

8.1 In terms of the number of staff employed, the size of its annual budget and the number of offices from which it operates, the Australian Taxation Office (ATO) must be considered as one of the largest bureaucracies within the Commonwealth.

8.2 Like any other large organisation, control and management of resources is fundamental to the successful achievement of the organisation's goals. The Committee devoted a significant proportion of its time during the Inquiry in examining the current financial position of the ATO. This examination was made particularly difficult as a result of the Inquiry spanning three financial years. To the greatest extent possible this chapter concentrates on resources available to the ATO for 1993-94. However, where appropriate, reference is made to the financial position of the ATO in 1991-92 and 1992-93.

#### Running Costs

8.3 In accordance with the budgetary arrangements applying to all Commonwealth departments, the ATO is provided with running costs for the purpose of facilitating the provision of its programs.

## Definition

8.4 Running costs are defined by the Department of Finance in the following way:

Conceptually, running costs represent the full current and minor capital costs of resources used by departments and agencies in providing government services. In practice, however, running costs budgets do not include:

- . program monies, for example:
  - transfer payments (pensions, grants, subsidies etc); and
  - appropriations under 'Other Services' which, although of a running cost nature, are appropriated as program monies;
- . major capital expenditure (mainly Information Technology related purchases); and
- . various accruing expenses (eg superannuation, depreciation) which are incurred in the course of on-going operations. These accrual accounting exceptions are being progressively reviewed to assess the practicality of inclusion in future department and agency running costs budgets.<sup>1</sup>

8.5 In 1993-94 the ATO was allocated almost \$1 127 billion for running costs. In terms of the running costs available to Government departments, this allocation establishes the ATO as the second largest Commonwealth operation after the Department of Defence.<sup>2</sup>

8.6 Within this funding allocation are amounts specifically provided for the conduct of the modernisation program. These funds were provided to the ATO as part of the Modernisation Funding Agreement between the ATO and Department of Finance. This funding is discussed more fully in Chapter 7.

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1. Department of Finance, *Running Costs Arrangements Handbook*, September 1992, p. 3.
  2. *Budget Statements 1993-94 Budget Paper No. 1, Statement 3*, AGPS, Canberra, 1993, p. 3.305.

## Human Resources

### Salaries and Staff

8.7 Table 8.1 sets out the allocations for salaries and the Average Staffing Level (ASL) of the ATO for the past two financial years and the estimates of salaries expenditure and staffing for the current year and the next three years.<sup>3</sup>

Table 8.1: Salary and ASL 1991-92 to 1996-97

Year	Salaries (\$m)	ASL
1991-92	598.6	18 795
1992-93	623.7	18 036
1993-94	679.9 est	17 500 est
1994-95	603.1 est	16 915 est
1995-96	614.1 est	16 200 est
1996-97	601.1 est	15 470 est

Sources: *Budget Statements 1992-93 Budget Paper No. 1*, AGPS, Canberra, 1992, p. 3.312; *Budget Statements 1993-94 Budget Paper No. 1*, AGPS, Canberra, 1993, p. 3.307

8.8 With the exception of funding provided for modernisation, salary and staff resources can be allocated between programs as ATO management deems appropriate.

8.9 The Committee noted that staff numbers are forecast to fall significantly in the future. At the same time the level of salary funding is estimated to fluctuate between an historical high in 1993-94 of nearly \$680 million and just over \$600 million in 1996-97. These changes are anticipated to result in an increase in the average salary paid to employees of 22% over the period 1991-92 to 1996-97.

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3. ASL is defined as the average number of employees receiving salary/wage over a financial year, with adjustments for casual and part-time employees to show the full time equivalent.

8.10 Several factors are expected to affect the salaries and staffing levels of the ATO over coming years. They are:

- . the modernisation dividend (see Chapter 7);
- . the Australian Public Service (APS) efficiency dividend;
- . the impact of economic growth on workload;
- . a reduction in processing staff; and
- . new policy projects approved by the Government.

8.11 In evidence, the ATO acknowledged that for some time it had been aware of the difficulty of meeting its salary commitments in the 1992-93 and 1993-94 financial years.<sup>4</sup> Significantly, the figures in Table 8.1 suggest the ATO's greatest difficulty may be in 1994-95 when salary reductions will require the loss of over 500 staff. Based on the current average salary estimated for 1993-94, the ATO would require a salary budget in 1994-95 of \$657 million, that is, \$54 million more than is currently anticipated to be available. By 1996-97 current forecasts of staff will allow the ATO to balance salary resources required and salary resources allocated.

8.12 The ATO explained that the salary difficulties had resulted from a combination of factors, specifically the effect of economic recession and reduced growth in workload.<sup>5</sup> (Workload reductions impact on resources through the operations of a formula discussed later in this chapter). In essence, the ATO had budgeted at the commencement of its modernisation program for a staff attrition rate nearly double that which resulted in 1991-92 and 1992-93.<sup>6</sup> With fewer staff leaving, promotion opportunities were reduced and the ATO average salary level rose as officers moved to higher classification points in their pay ranges. At the same time, the ATO's salary resource was being reduced annually to reflect the efficiencies predicted to have flowed from the modernisation program. Put simply, the ATO had less resources to pay an increasing salary bill.

8.13 In response to these circumstances, the ATO moved to halt all base grade recruitment in the latter part of 1991-92 and into 1992-93.<sup>7</sup> An approach was also made to the Department of Finance to provide supplementary funding for the

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4. Evidence, vol. 4, p. S903.

5. Evidence, vol. 4, p. S903.

6. Evidence, vol. 4, p. S903.

7. Evidence, vol. 4, p. 1158; vol. 15, p. S2982; Senate Estimates Committee B, *Additional Information*, vol. 4, November 1992, p. 149.

salary increment which the ATO was bound to pay.<sup>8</sup> Such an approach was outside the rules for supplementing running costs.

8.14 A number of strategies were adopted in 1991-92, and again in 1992-93, to reduce the number of staff on the ATO's payroll. They included:

- . the release of staff to the Departments of Social Security and Employment, Education and Training who were in the process of recruiting additional officers to meet workload increases;<sup>9</sup>
- . seeking additional funding for growth in work in the Child Support Agency and for an enhancement of the Tax File Number audit function;
- . providing increased opportunities for staff to avail themselves of flexible working conditions such as study leave without pay; and
- . increasing productivity wherever possible, thereby reducing the need for additional staff.<sup>10</sup>

8.15 Despite the ATO's efforts, there was still insufficient funding to cover the projected salary bill in 1992-93. The ATO therefore utilised the facilities available under the running costs arrangements to supplement their salary budget. Salary funding of \$8.7 million saved in 1991-92 through lower recruitment was carried over into the 1992-93 budget.

8.16 Money allocated for administrative expenses in 1991-92, which was unspent, was also carried over and transferred to the salaries budget as was an amount of \$27.5 million allocated in 1992-93 to administrative expenses. In so doing the amount of money transferred was reduced by a factor of 20% in accordance with standard procedures. Furthermore, the ATO borrowed \$19 million from its 1993-94 administrative expenses allocation which was also converted into salary funding in 1992-93.<sup>11</sup> The total addition to the salaries budget from these arrangements was \$60.1 million. The Committee noted that all of these transfers, carry forwards and borrowings were permissible under the running costs arrangements.<sup>12</sup>

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8. Senate Estimates Committee B, op. cit., p. 149.

9. Evidence, vol. 4, p. 1179.

10. Evidence, vol. 4, p. S903.

11. See Chapter 9 for further discussion of the financial arrangements concerning this transfer.

12. Evidence, vol. 4, p. 1153.

8.17 The 1993-94 Budget Papers indicated that the ATO actually expended \$1.0347 billion on running costs in 1992-93. Of this amount, \$623.7 million was expended on salaries.<sup>13</sup> This compares to the \$615 million estimated in the 1992-93 Budget and the actual allocation made to the ATO in 1992-93 of \$632.7 million. This outcome supported the proposition put to the Committee during its hearings that the ATO would underspend its salary allocation in 1992-93.<sup>14</sup>

8.18 Projections for 1993-94 and the following three years (the forward years) are based on a number of assumptions. Such assumptions are inherent in any budgeting system. To meet the projected staff levels from within current budget allocations, the ATO will require one or more of the following to occur:

- . an increase in economic activity;
- . an increase in staff attrition; and/or
- . an increase in the ATO's functions and resource allocations from government.

8.19 Extra resources may be forthcoming to the ATO if the Government determines that new functions should be allocated to it. As outlined in evidence this has happened in the previous three years with the ATO receiving additional funding to perform additional functions. The functions included:

- . the Child Support Agency;
- . Tax File Number initiatives;
- . the Large Case Audit program;
- . the Business Tax Review program;
- . the Employment Declaration Unit;
- . the Higher Education Contribution;

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13. *Budget Statements 1993-94, Budget Paper No. 1*, AGPS, Canberra, 1993, p. 3.307.

14. Evidence, vol. 4, pp. 1154, 1160.

- . the Training Guarantee; and
- . the Superannuation Guarantee.<sup>15</sup>

8.20 In September 1992, the Government announced a program of additional funding for the ATO to carry out a compliance improvement campaign. Funding under this project totalled \$114.5 million over three years. The first allocation of funding was for 1993-94 although no revenue gains were expected to flow until 1994-95. In the event that the functions of the compliance improvement program can be carried out by staff already employed in the ATO, the additional funding provided to the ATO will reduce the 'gap' between salary funding available and salary funding required. This point was acknowledged by the ATO in evidence to the Committee.<sup>16</sup> Further analysis of the compliance improvement program is included later in this chapter.

8.21 As at June 1993, the ATO acknowledged that remaining within its salary resource allocations was likely to be a 'close run thing' for 1993-94 in the absence of borrowing and the deferment of part of the payment of the modernisation dividend.<sup>17</sup> That deferment, worth \$7 million, was permissible under the funding agreement for modernisation. The consequence of this deferment was to reduce the 1994-95 salary allocation of the ATO by a further \$7.7 million. For the ATO to be able to borrow from future year allocations, to cover the 1993-94 salary bill, it will be necessary for the ATO and Department of Finance to negotiate a resource agreement which would permit the borrowing on the basis of additional efficiencies being generated within the ATO. Such a borrowing would incur an interest charge.

8.22 The Committee concluded that the ATO was currently budgeting and managing current year staff resources on the basis of anticipated increases in resources in future years. While the Committee recognises that such management practices are permissible under current government frameworks, it wishes to express its concern that such arrangements should not be allowed to extend over an indefinite period of time. While it is reasonable for the ATO to anticipate economic growth in the forward years and some increase in staff attrition, the Committee considers prolonged maintenance of an artificially high staffing level could ultimately lead to structural inefficiencies in the ATO's workforce.

8.23 In addition the Committee considers the program of staff movement (transfer) to other departments should be critically evaluated by the Auditor-General to ensure staff have not been disadvantaged by such movements. Given that the

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15. Evidence, vol. 4, p. 1136.  
16. Evidence, vol. 4, pp. 1147-8.  
17. Evidence, vol. 4, p. 1516.

ATO anticipates that staff will 'return' to the ATO when economic conditions produce staff growth in the taxation area,<sup>18</sup> the Committee considers the Auditor-General should also evaluate the terms and conditions under which such movements were effected to ensure they are in the best interests of the individuals affected and the APS as a whole.

8.24           **The Committee recommends that:**

the Auditor-General evaluate and report on the efficiency and effectiveness of the program of excess staff transfers between the Australian Taxation Office and other departments.

8.25           In conducting this evaluation the Auditor-General should consider the terms and conditions under which such transfers occur and the rights and obligations of staff transferred.

#### **Staff Morale**

8.26           As mentioned previously, the ATO was forced to reduce its recruitment activity as a result of the staffing circumstances it encountered in 1991-92. Appointments to the ATO declined between 1990-91 and 1991-92 by 875.<sup>19</sup> The reduced attrition rate and limitations on recruitment meant fewer opportunities for officer promotion and restrictions on the filling of vacant positions within the ATO.

8.27           The Committee recognised that a potential consequence of these events was an increase in job dissatisfaction among staff. A reduction in recruitment inevitably leads to the insulation of an organisation from external views, cultures, attitudes and opinions. As indicated by the evidence of the Department of Finance, the ATO's average salary has been rising over the past twelve months.<sup>20</sup> Moreover, staff retirement rates have remained relatively constant despite the recession, indicating that retirements as a proportion of total attrition has been increasing.<sup>21</sup>

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18. Evidence, vol. 4, p. 1202.

19. Evidence, vol. 17, p. S3982.

20. Evidence, vol. 14, p. S2823.

21. Exhibit No. 30.

8.28 Evidence of forced staff movement stemming from the decentralisation of ATO offices was raised with the Committee.<sup>22</sup> In the Committee's opinion, any promotion or transfer which placed staff in positions for which they were neither qualified nor prepared could only lead to a reduction in the efficiency of the ATO. Moreover, forced movements were considered incompatible with the co-operative thrust of the modernisation development. The ATO acknowledged that transfers based on random selection had occurred in a given instance brought to the Committee's attention.<sup>23</sup> The Committee noted that the use of a random selection procedure had been considered necessary as the Group receiving the surplus staff could not be guaranteed the most meritorious officers from a merit based selection procedure because officers were transferring at level. While the Committee has also noted the ATO's claims that a ballot was the fairest method of making selections for transfer and that this procedure was not excluded by the *Public Service Act 1922*, the Committee is not satisfied that this procedure demonstrated a good staff management ethos. Evaluation of the decentralisation program is contained in Chapter 7.

### Staff Skills and Training

8.29 The Committee was cognisant of the importance of staff skills as a fundamental contributor to the performance of the ATO. While evaluation of a general skill base was not possible, the Committee considered criticisms raised in evidence of the current abilities and skills of ATO staff. An examination of the ATO's audit staff is included in Chapter 11.

8.30 Criticisms of ATO staff concentrated on the technical and interpersonal skills of those staff who have to deal with taxpayers on a face to face basis. While it is easy to generalise about such matters, such criticisms reflect the importance of maintaining a consistent quality control program and providing accessible avenues of redress for those who are dissatisfied.

8.31 In particular, the Committee was concerned by suggestions that some ATO staff had been arrogant<sup>24</sup> and insensitive,<sup>25</sup> demonstrated poor English skills<sup>26</sup> and were inflexible.<sup>27</sup> While these instances may have been isolated and the Committee noted ATO evidence of community support for its performance<sup>28</sup>

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22. Evidence, vol. 15, p. S2910.

23. Evidence, vol. 15, p. S3118.

24. Evidence, vol. 14, p. S2789.

25. Evidence, vol. 14, p. S2789.

26. Evidence, vol. 2, p. 707.

27. Evidence, vol. 4, p. S699; vol. 14, p. S2786.

28. Evidence, vol. 4, p. S756.

and public support for ATO officers,<sup>29</sup> Committee members were satisfied that there was sufficient anecdotal evidence of problems with interaction between ATO staff and the public to warrant consideration by the ATO of strategies to improve ATO staff's interpersonal skills. Such a program should concentrate on communications skills and dealing with stress. Importantly, the Committee considers any attempt to improve the perception of the ATO in the eyes of taxpayers needs to be more than a general public relations exercise. Rather, it should address the fundamental nature of the interaction between the ATO's moves to client based revenue collection groups ('one-stop' shops) and the importance of relationships to the success of such a venture.<sup>30</sup>

8.32 ATO allocations to staff training programs are significant.<sup>31</sup> While training in interpersonal competencies is already a feature of these programs, the Committee considers a dedicated program for those officers interacting with the public regularly should be implemented nationally. Such a program should involve monitoring and evaluating taxpayer reaction to staff and the services they provide. In addition the program should provide support and counselling for staff who have regular contact with the public.

8.33 **The Committee recommends that:**

**the Australian Taxation Office introduce a coordinated national program of training, counselling and support for officers interacting regularly with taxpayers for the purpose of improving the interpersonal skills of those officers.**

8.34 As a result of the Income Tax Compliance/Enforcement Strategy, the Committee noted the importance interpersonal skills will play for staff conducting record keeping reviews in the small business segment. The Committee urges the ATO to give a high priority to this skill when selecting staff.

8.35 As outlined in Chapter 3, the Committee considered the ATO should have more flexibility in setting the wages and conditions of senior technical staff in

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29. Evidence, vol. 2, p. S124.

30. Evidence, vol. 4, p. S751.

31. Evidence, vol. 3, p. 756.

the context of a move to the establishment of a Taxation Commission. In addition, the Committee considered the ATO needed to give consideration to the following three factors:

- . the utilisation of Senior Executive Service (SES) positions;
- . methods to transfer skills across the organisation; and
- . the capacity to recruit external staff either as part-time employees or on contractual terms.

8.36 The Committee regarded the general move to management oriented profiles for the SES to be to the detriment of technical capacity. Evidence from witnesses clearly indicated the importance of maintaining technical capacity.<sup>32</sup> With flexibility of employment within a global budget, the Committee considered the ATO should allocate SES positions to senior technical officers for the purposes of maintaining a specialised resource base.

8.37 As economic activity increases there is a potential for senior ATO officers to be enticed again into private practice. Critical to the preservation and growth of technical knowledge will be the transfer of knowledge and skills to junior staff on an on-going basis. While officers need not be removed from their line of responsibilities on a full time basis, there should be the opportunity for articulate technical officers to present courses and instruct others in methods of operation or interpretation on an as required basis. To this end, the Committee urges the ATO to develop in-house training so that staff routinely train their colleagues as part of their operational duties.

8.38 As previously discussed, the Committee was concerned with evidence of a loss of senior staff as a proportion of the ATO's total resources. Any loss of technical skill at a time when the taxation law is generally considered to be increasing in technicality raises questions about the capacity of the ATO to fulfil properly its functions under the self assessment regime. In particular, the advising role of the Office is clearly a critical feature for the future success of the regime. Any loss of staff, or staff skills, in the area of technical understanding and communication places at risk taxpayers' capacity to comply with the taxation law. Such a skills loss of the variety discussed can be compensated for through a number of mechanisms such as:

the development of technical information databases;

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32. Evidence, vol. 3, p. S474; vol. 3, pp. 702, 706.

- . the establishment of more technological assessment systems;
- . a strategic diminution in taxpayer involvement in the taxation system through greater utilisation of taxes at source; and
- . law changes to standardise expense deductions and clarify income concepts.<sup>33</sup>

8.39 All of these methods however, will take time to implement and several will require political and social commitment. In the meantime the ATO must address the fundamental issue of how to retain a fully qualified and professional staff base.

8.40 The Committee gave consideration to three possible avenues for maintaining technical skill in the future. They were:

- . technical and skills based training;
- . interaction with the private sector; and
- . the extended utilisation of retired staff.

### **Technical and Skills Based Training**

8.41 The ATO's commitment to the maintenance and improvement of its tax technical skill and professionalism was evidenced to the Committee.<sup>34</sup> The utilisation of dedicated professional development officers, development of the Australian Taxation Studies Program (ATAX) and the training of managers through the Management in the Nineties (MIN) program were all noted. The Committee considered further utilisation of professional skills transfer through a mentor program should be evaluated by the ATO. Such a program would draw upon the skill and knowledge of senior technical officers in the development of junior officers. At the same time concepts and ideas for the continued development of a technical capacity could be passed on by the senior staff.

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33. The Committee also heard evidence of the development of a regional structure in the ATO to spread the technical expertise across branches. This process has implications for workforce planning and efficiency. Evidence, vol. 3, p. 724.

34. Evidence, vol. 4, p. S757.

8.42 Development of an internal tax technical database will clearly assist in the development of consistency and accuracy of technical advice as will the use of computerised decision tools.<sup>35</sup> The Committee considers the ATO needs to further evaluate mechanisms to allow technical issues raised in new legislation to be conveyed promptly to ATO staff. Specialists within the legislation development area of the ATO should be utilised in the preparation of information brochures and in the education of ATO officers concerning the technical detail of the legislation. Such a program would benefit both the instructor and ATO staff in that it would facilitate discussion of the issues related to the legislation's development and construction by a diverse group of people having practical experience in the impact of legislative change.

8.43 The Committee notes the establishment in New Zealand of a Tax Education Office to assist in the provision of information to those directly and indirectly involved in providing tax advice to businesses. While the objective of this body is to assist in filling the information gap during the development stages of legislative change, the Committee considers the interaction of the private sector, the revenue authorities and the Government in identifying those areas of greatest uncertainty and dispute is valuable and worthy of further evaluation. In the Committee's view such an operation could provide a preliminary model for the development of an educational facility.

8.44 **The Committee recommends that:**

**the Australian Taxation Office, through the utilisation of officers responsible for legislative developments, investigate and implement a method of informing and training technical officers and staff, who directly interrelate with taxpayers, about the progress of legislative developments.**

8.45 The role of the Legislative Services Group of the ATO is discussed in Chapter 11.

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35. Evidence, vol. 4, p. S779.

## Interaction with the Private Sector

8.46 An ever present problem for the skill level of the ATO for many decades has been the 'poaching' and loss of senior, experienced staff by entities within the private sector.<sup>36</sup> The specialist skills of these officers, particularly when they have a unique knowledge of a particular tax regime, make the services of these officers highly valuable to commercial practices.

8.47 The employment restrictions of the APS make it impossible for the ATO to retain these staff members on the basis of a salary comparison alone. The Committee was advised that the private sector salaries for these highly sought after staff were 25% - 100% higher than the salaries paid by the ATO.<sup>37</sup> This would equate to an increased salary payment of between \$15 000 and \$60 000. While the recession has led to a slowing in the rate of departure from the ATO, the problem remains.<sup>38</sup>

8.48 The ATO has identified the staffing rules applying across the APS as a significant restraint upon its capacity to provide the necessary levels of service to the community. In an information paper to the Committee, the Taxation Office stated:

The general 'rules' that govern the Australian Public Service (APS) do not recognise the particular market within which the ATO operates, in that they fail to assist us in addressing our obligation to provide quality service to the community. At a more specific level, we are, for example, bound by the controls over our staffing levels on the number of senior technical specialists positions made available to us at both Senior Executive Service (SES), and Senior Officer level (SOG). We think there should be greater flexibility in the application of these rules to enable us to meet the needs of our client base.<sup>39</sup>

8.49 The recruitment of expert technical staff to the ATO from the private sector is clearly limited by salary differentials. In addition any temporary transfers or placements are restricted as a result of the secrecy provisions of section 16 of the *Income Tax Assessment Act 1936*. Temporary placement of ATO officers in the

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36. Exhibit No. 17.

37. Evidence, vol. 1, p. 79.

38. Evidence, vol. 1, p. 79.

39. Exhibit No. 17, p. 3.

private sector is similarly limited with the additional complication of a corporate taxpayer not wanting the ATO to know of its taxation structures and strategies. Such practical impediments restrict the full and free flow of knowledge between the ATO and private sector taxpayers. Moreover, they create an adversarial system of interaction.

8.50 The Committee received evidence of the ATO's determination to pursue placements in the private sector for its staff.<sup>40</sup> Such placements were due to commence during 1993-94. While the Committee recognised the potential for increased knowledge of commercial practices and skills, it also cautioned against holding too high an expectation for this program, given the inherent difficulties in providing for such interchange.<sup>41</sup>

8.51 Furthermore, the Committee considered the ATO should review all position selection criteria to ensure they do not act as a barrier to external recruitment through the specification of public sector requirements not related to technical skill.

#### **The Use of Retired Staff**

8.52 Simply stated, the loss of technical knowledge of both the law and administrative practices, which follows the retirement of senior technical officers, is an unnecessary waste to the Australian economy. The Committee considered there was an advantage in the ATO identifying opportunities for the utilisation of retired technical staff in the provision of training to officers on a part-time basis for a period after retirement. Such a program of information transfer would not need to utilise retired officers for an extended period and should be managed in a sensitive and professional manner. Retired practitioners from the private sector should also be utilised as a training resource. The Committee has concluded that any program to utilise retired staff should preferably be arranged prior to an officer's retirement, be limited to training and be instigated by the ATO. Such precautions are considered necessary to protect against the re-employment of former staff in their substantive positions at consultant rates.

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40. Evidence, vol. 3, p. 955; vol. 18, p. S4139.

41. Evidence, vol. 3, p. 592.

8.53           **The Committee recommends that:**

the Australian Taxation Office investigate methods to utilise retired officers and retired private sector practitioners in the training of staff.

8.54           The Committee recognised the importance of not merely maintaining but expanding the ATO's technical skills base. Through a combination of systems, training, recruitment and effective staff management the Committee considers that over time the ATC could improve its technical skill base.

#### **Future Priority Requirements**

8.55           Without seeking to be prescriptive, the Committee considered that the future resource demands of the ATO would lie principally in the acquisition and development of technical skills. Staff numbers in total are currently constrained by resource agreements applying in respect of the modernisation program to the degree that efficiencies from that program are established on the basis that the ATO should reduce staff numbers by 3000 over a ten year period.

8.56           Without commenting on the additional resources allocated to the ATO for the Income Tax Compliance/Enforcement Strategy, the Committee considered any further additional resources provided to the ATO should be by way of funding for skills advances and not additional staff.

8.57           The Committee heard general evidence of the need for a higher level of technical support for staff.<sup>42</sup> In the Committee's view greater attention to the promotion of technical skills, the development of client focused work teams, mechanisms to transmit legal interpretations to staff and a general focus on the skills necessary to service taxpayers will improve both the perception and reality of the skills of the ATO.

8.58           The Committee noted various proposals that ATO staff productivity increases which resulted in increases in revenue would be rewarded through increases in pay. That is, the additional revenue generated by ATO staff may in some way be a factor in determining the quantity of reward payable as a result of productivity increases.

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42.   Evidence, vol. 5, p. 5580; vol. 3, pp. S473, S476; vol. 15, p. S3164.

8.59 The Committee recognises that productivity needs to be measured and that measurement is often difficult. However it is firmly of the view that revenue gains cannot be seen, either directly or indirectly, to be part of productivity measurement. A community perception, even if ill founded, that tax officers were in some way awarded salary increases based on revenue increases cannot be allowed to develop. It would lead to a mistrust of the ATO and, more generally, a serious lack of faith in the taxation system. In the Committee's opinion, productivity should only be measured by reference to compliance and service improvements, without reference to the revenue implications of these improvements.

8.60 The Committee recommends that:

- . the Australian Taxation Office and relevant staff unions cease all negotiations for increases in staff salaries based on increased revenue returns to the Commonwealth; and
- . the Government amend its guidelines on the payment of productivity based wage increases to remove any possibility of revenue returns being used as a measure of productivity.

### **Administrative Expenses**

8.61 The ATO has been allocated \$239.1 million for the payment of administrative expenses in 1993-94. This contrasts with expenditure in 1992-93 of \$214 million out of a total allocation in that year of \$245 million.

8.62 Administrative expenses cover expenditure on items such as:

- . Comcare premiums;
- . computer services;
- . consultants and the administrative component of fees paid to Holders of Public Office and members of Committees;
- . fees and other costs associated with the engagement of persons through private sector personnel bureaux (as distinct from payments to employees, contract or otherwise, which should be paid through the salaries notional items);

- . freight and carriage;
- . furniture and fittings;
- . incidental and other expenditure;
- . minor capital equipment;
- . office requisites and equipment, stationery and printing;
- . office services;
- . postage, telegrams, and telephone services;
- . staff housing; and
- . travel allowance and subsistence.<sup>43</sup>

8.63 A significant proportion of the administrative expenses allocation to the ATO is quarantined for expenditure on the modernisation program. It is therefore difficult to make absolute judgements concerning expenditure of this allocation. Nevertheless Table 8.2 provides a comparison of estimated and actual administrative expenditure over the last five years.

**Table 8.2: Estimated and Actual Administrative Expenditure - Australian Taxation Office 1988-89 to 1992-93** (All figures are in \$'000)

	1988-89	1989-90	1990-91	1991-92	1992-93
Estimated Expenditure	150 447	207 601	256 818	277 790	247 970
Actual Expenditure	150 025	185 630	234 771	227 684	205 704

Sources: Explanatory Notes and Program Performance Statements for the Treasury Portfolio, 1989-90 - 1993-94

8.64 Table 8.2 shows that the ATO has consistently underspent its operational funding over the past five years, while the trend in expenditure has declined over the past three years. Taken alone the failure to spend all administrative funds allocated demonstrates neither poor administration nor over-

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43. *Finance Circular* 1990/16, November 1990.

funding. Rather the extent of expenditure may have been affected by several factors including management priorities, new program commencements, demand factors and timing issues.

8.65 Several other important factors affected the pattern of the estimated expenditure. They included:

- . commencement of the Modernisation Program (1989-90);
- . progressive expansion of the Child Support program;
- . introduction of the Tax File Number and Large Case Audit Programs (1988-89);
- . implementation of TaxPack (1989-90);
- . payment of Comcare premiums (1990-91);
- . payment of superannuation premiums; and
- . introduction of many new policy proposals.

8.66 The Committee noted that the patterns of expenditure for administration were significantly skewed as a result of both the modernisation program and the additional functions periodically allocated to the ATO.

8.67 The pattern of expenditure also suggested to the Committee that there was a sizeable level of discretionary expenditure. Most notable was the underspending which had occurred in the Child Support Scheme across all financial years. A component of this lower than estimated expenditure can be explained by the time delays experienced in establishing the organisation. However, given the deficiencies of the Child Support Agency, outlined in the Fogarty Report,<sup>44</sup> the Committee considers it unacceptable that the ATO failed to expend even 60% of the allocated administrative funds in 1991-92 and only two thirds of the 1992-93 allocation. The ATO's performance in this area is unsatisfactory.

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44. Department of Social Security, *Child Support: Formula for Australia, a Report from the Child Support Consultative Group*, AGPS, Canberra, 1988.

Accordingly, the Committee recommends that:

. the Joint Select Committee on Certain Family Law Issues review the allocation to and expenditure of administrative expenses by the Child Support Agency.

8.69 Also of significance in the administration expenses item was the transfer of funds in 1989-90 and 1990-91 from salaries to administrative expenses and the consequent underspending in that item. This indicated to the Committee that the ATO had identified in previous years a need for additional administrative or operational funds. The size of the movements of funds, together with the reversal in the direction of funding towards salaries, indicated to the Committee a significant change in the priorities of the ATO.

8.70 As noted earlier in this chapter, the Committee was informed of movements of funds within the running cost rules by the ATO in respect of the 1991-92, 1992-93 and 1993-94 financial years. This advice included the identification of an underspend and carryover of an amount equal to 20% of the non-modernisation administrative expenses allocation of the ATO in 1991-92. The Committee sought from the ATO details of how and where such savings were achieved in program commitments.

8.71 In responding to the Committee's request for information, the ATO noted that it was unable to provide a detailed tracking of administrative savings due to the central accounting system not having the capacity, prior to 1992-93, to record planned expenditure. Nevertheless the ATO was able to identify the following areas of savings during 1991-92:

. an amount of \$8 million was never allocated for expenditure, that is, this sum was quarantined from expenditure despite its having been appropriated by the Parliament;

. a winding down of expenditure in areas of high activity for example the implementation phase of the Tax File Number Project, reductions in consultants and contractors for the Information Technology Group and reductions resulting from modernisation initiatives;

. the signing of contracts which reduced overall cost in areas such as telephone usage, mail, stores and travel;

. the introduction of market forces for the purchase of items devolved from Corporate Services; and

general cut backs following the Commissioner's request to staff for care in the expenditure of funds.<sup>45</sup>

8.72 The following absolute savings were also identified by the ATO:

<u>Expenditure item:</u>	<u>Savings (\$m):</u>
operational travel	0.8
office requisites	9.8
office services	0.28
storage and transport	0.37
computer services	0.57
minor capital expenditure	1.8
other government agencies	3.9
general program reductions	10.0 <sup>46</sup>

8.73 In addition, the ATO noted that some expenditure savings had been offset by net operational expenditure increases particularly in the areas of training and staff related costs. In considering this information the Committee was again concerned at the apparent lack of management information available on such a crucial issue as resources.

8.74 In respect of the major savings identified by the ATO the Committee was particularly concerned at an apparent anomaly in respect of the savings from planned reductions in the high activity areas. The Committee considered the savings identified should have been reflected earlier in the Budget allocations made to the ATO by the Department of Finance. Thus, for example, at the time the Tax File Number program was established, funding for the implementation phases should have been limited to those years in which implementation was necessary. Consequently, while the Committee appreciated that expenditure may have reduced, it considered allocations should have similarly been varied. To that extent, the Committee could not accept that these savings could be used to explain the absolute decline in expenditure.

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45. Evidence, vol. 15, pp. S3162-3.

46. Evidence, vol. 15, pp. S3162-3.

8.75 Moreover, on the general issue, the Committee was concerned at the apparent contradiction in the planning of the ATO in having moved unspent funds into administrative expenses in one year and then having been able to affect such substantive savings in a following year. The Committee noted the Department of Finance did not, as part of the Public Service management reforms, closely scrutinise the detailed management decisions concerning financial resources. However, given the importance of operational funds to the output performance of the ATO, the Committee was concerned that the degree of cutback that had been managed may have been at the expense of operational efficiency and thus revenue returns.

8.76 While acknowledging management's right to strike a balance between staff resources and administrative expenditure, the Committee believed the degree of contraction in operational funding and the size of the shifts to salary payments indicated a fundamental imbalance and a profound risk to the operational performance of the ATO.

8.77 Conspicuous too was the level of administrative resources allocated to, or from, the national office.<sup>47</sup> Although this reflects primarily the control of the modernisation program and the centralisation of this program's budget, the Committee considered the level of funding to be something of an anomaly given the moves towards devolution.

8.78 Determination by the ATO to move to a greater devolution of resources is accepted by the Committee, although it considers that this movement must be carefully monitored and only undertaken where a clear case of efficiency is evidenced.<sup>48</sup> While the Committee acknowledges that the ATO has moved to monitor the process of devolution in respect of its corporate services functions,<sup>49</sup> there is in the Committee's view a need for an external review of the ATO's administrative expenditure requirements.

8.79 Consequently, the Committee recommends that:

**the Department of Finance conduct a comprehensive review and evaluation of the base administrative expenditure requirements of the Australian Taxation Office.**

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47. Evidence, vol. 4, p. S928.

48. Evidence, vol. 4, p. S909.

49. *Program Performance Statements 1993-94 Treasury Portfolio Budget Related Paper No. 7.17*, p. 270.

## Property

8.80 From 1992-93 the ATO's funding allocation for property was, in accordance with APS wide guidelines, incorporated into running costs. The major effects of this change will not become manifest until sometime during 1993-94, when a resource agreement is negotiated for this item with the Department of Finance.

8.81 Property Operating Expenses provide for payments on rent, tenant costs (such as power and cleaning), repairs and maintenance, fitout, minor works and minor property acquisitions.<sup>50</sup>

8.82 For 1993-94 the ATO has been allocated \$212.8 million for Property Operating Expenses.<sup>51</sup> This compares with \$199.7 million spent on Property Operating Expenses in 1992-93.<sup>52</sup> The Committee noted that the ATO's Property Operating Expenses allocation for 1993-94 was more than 30% higher than any other Commonwealth department or major agency, excluding the Department of Defence.<sup>53</sup> A majority of the Property Operating Expenses funding covers the payment of rent and associated costs in respect of the ATO's branch office structure. This item is therefore directly affected by the decentralisation plans of the Office. The decentralisation program is discussed in Chapter 7.

8.83 The Committee noted evidence from the ATO which set out the current locations of all premises occupied by the ATO.<sup>54</sup> On the basis of the number of properties occupied and value of rent paid by the ATO annually, the ATO could be recognised as one of Australia's major property tenants.<sup>55</sup> The Corporate Services Group based in the national office in Canberra is responsible for the management of the ATO's \$170 million plus property portfolio.

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50. Department of Finance, *Running Costs Arrangements Handbook*, September 1992, p. 29.

51. *Budget Statements 1993-94, Budget Paper No. 1*, AGPS, Canberra, 1993, p. 3.307.

52. *ibid.*

53. *ibid.*

54. Evidence, vol. 17, p. S3517.

55. Evidence, vol. 16, p. S3190.

8.84 The property resources of the ATO are impacted upon by the operation of the modernisation agreement through the application of clause 5 (vi) which states:

... offsets for any given year are required when total ATO space Australia-wide exceeds 20 square metres per ASL unit, based on the ASL for that year.<sup>56</sup>

8.85 Evidence from the ATO indicated that, as at October 1992, the area per ASL for all branch offices across Australia was in excess of the threshold.<sup>57</sup> The Committee noted that, as the ATO's staff resources were not expected to grow significantly in the near future, the threshold of 20 square metres was unlikely to be achieved. Consequently, the ATO must be prepared to forego property resources in accordance with the modernisation resource agreement.

8.86 The Committee considered that, for the purposes of facilitating a medium to long term planning strategy, this issue needs to be addressed in the context of the property resource agreement between the Department of Finance and the ATO. Nevertheless, the Committee has concluded that the ATO should commence planning to manage a reduction in property resources over the medium term, including the relocation of offices into cheaper accommodation and the negotiation of beneficial tenancy arrangements.

8.87 The Committee recommends that:

the Australian Taxation Office commence an immediate review of its property program to ensure that the threshold space allocations required by the Modernisation Funding Agreement can be achieved within three years.

## Legal Services

8.88 Since 1992-93 the legal practice area of the Attorney-General's Department has operated on a user-pays basis. Funding was allocated to each agency in that year for the sole purpose of purchasing these services. Under transitional

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56. *ATO Modernisation Agreement Attachment B clause 5 (vi).*

57. Evidence, vol. 15, p. S3010.

arrangements, agencies cannot use those funds for other running costs purposes until after 1994-95. The level of resources allocated to each agency is reviewed annually.

8.89 In 1993-94 the ATO has been allocated \$13.25 million for the purchase of legal services. This is 60% greater than the ATO's expenditure in 1992-93. The role of the ATO as a litigant is discussed in Chapter 14.

## Other Services

8.90 Other than running costs, the ATO is annually appropriated by the Parliament monies for other services. These are specific line item appropriations to cover payments made by the ATO which are not of an annual running cost nature. For 1993-94 the other services appropriation consisted of:

- . compensation and legal expenses (\$12.5 million);
- . Child Support Agency - Payments to cover cheque dishonours, incorrect maintenance payments and refunds of over payments (\$12 million);
- . compensation relating to administration of taxation assessments (\$426 000); and
- . compensation relating to administration of collections and assessments under the *Child Support (Registration and Collection) Act 1988* and the *Child Support (Assessment) Act 1989* (\$60 000).

8.91 The Committee did not consider these appropriations in detail as they are primarily used for making compensation payments to individuals. However, discussion of the facilities for compensating taxpayers aggrieved by the ATO and power of the ATO as a litigant are included in Chapters 13 and 14.

## The Efficiency Dividend

8.92 The ATO's resources have been, and will continue to be, progressively reduced per annum to reflect the payment of two efficiency dividends. The first is the modernisation dividend discussed in Chapter 7, while the second is the standard APS efficiency dividend of 1.25% per annum of the ATO's gross running costs budget. This dividend reflects anticipated productivity, management and administrative improvements within the ATO. The dividend is an APS wide requirement and, while the Government has reaffirmed its commitment to this dividend up to and including 1993-94,<sup>58</sup> the Committee notes its recommendation in its Report 323, *Managing People in the Australian Public Service*, that the efficiency dividend be abandoned.

8.93 Table 8.3 illustrates the effect of the 1.25% efficiency dividend on the ASL of the ATO.

**Table 8.3: Effect of the 1.25% Efficiency Dividend on Australian Taxation Office's Approved Staffing Level (ASL) 1993-94 to 1996-97**

Year	Projected Reductions in ASL
1993-94	- 214
1994-95	- 210
1995-96	- 207
1996-97	- 207

Source: Evidence, vol. 14, p. S2827.

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58. Evidence, vol. 13, p. S2584.

8.94 The Committee noted that projected ASL reductions were based on anticipated reductions in the salaries budget. Based on the projected average salary of the ATO in each of the relevant years the salary implications of the 1.25% efficiency dividend would be as follows:

**Table 8.4: Estimated Salary Reduction in the Australian Taxation Office resulting from the 1.25% Efficiency Dividend 1993-94 to 1996-97 (based on projected average salary rates)**

Year	\$m
1993-94	8.3
1994-95	7.5
1995-96	7.8
1996-97	8.1

Source: *Budget Statements 1993-94 Budget Paper No.1*, AGPS, Canberra, 1993, p. 3.307.

8.95 The Government announced in the 1993-94 Budget its intention to review the operation of the efficiency dividend during 1993-94 and implement new arrangements in 1994-95.

8.96 As mentioned earlier in this chapter, the ATO is partially funded on an incremental basis as a consequence of the operation of a resource funding agreement between the Department of Finance and the ATO which seeks to fund the ATO's resources for demonstrated changes in workload. The formula seeks to make automatic adjustments to running costs resources without requiring the ATO to formally approach the Department of Finance.

8.97 The Committee was provided with a copy of the workload agreement by the Department of Finance, together with an explanation of how the formula had impacted upon the ATO's resources over the past three years.<sup>59</sup> After examination of the agreement the Committee was concerned that possible anomalies may exist within the agreement which distort its efficient operation. In particular, the Committee noted the agreement provided resources to the ATO on a variable rather than marginal basis. Additionally, no account was taken of resource allocations within the ATO. Thus it was theoretically possible for the ATO to obtain excessive resources by placing unnecessary additional staff in those areas where there was a demonstrated taxpayer growth at the expense of areas where revenue growth, or

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59. Evidence, vol. 13, p. S2582.

potential risk, was greatest. The Committee did not believe there was any substantive evidence of such allocations having been made deliberately but the theoretical point remained apparent. Furthermore, weaknesses in the formula identified by the Department of Finance were noted.

8.98 In addition, as the agreement placed no weight upon the relative efficiencies that modernisation was producing within the ATO, nor did it take account of the impact of resources added to the ATO through the New Policy process, the Committee has concluded the current workload formula needed major revision. As taxpayer numbers are not projected to increase significantly for some years, the workload formula is not anticipated to contribute substantially to ATO resources in the short term.<sup>60</sup> The Committee considers that the ATO and Department of Finance should seek to develop a more sophisticated model for the measurement of the impact of workload changes on resources, and such a formula should be reviewed and where necessary updated or modified on a regular basis.

8.99 The Committee recommends that:

the Department of Finance, in association with the Australian Taxation Office and the Australian Bureau of Statistics, review the workload formula and develop a new formula that seeks to model the marginal needs of the Australian Taxation Office in such a way that allows for medium term planning and management priority decision making.

### **Income Tax Compliance/Enforcement Strategy**

8.100 As previously outlined, additional resources were allocated to the ATO by the Government during the course of the Inquiry, for the purposes of a new Income Tax Compliance/Enforcement Strategy (the Strategy). The Strategy was outlined in a Statement on Tax Policy to the Parliament by the Treasurer on 16 September 1992.<sup>61</sup>

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60. Evidence, vol. 13, p. S2584.

61. Statement on Tax Policy, circulated by the Hon John Dawkins, MP, Treasurer of the Commonwealth of Australia, Canberra, 16 September 1992.

8.101 Additional funding for the ATO of \$114.5 million over three years commencing in financial year 1993-94 was included in the Strategy. The ATO estimated that these additional resources would allow the employment of approximately 630 full time staff and the collection of an additional \$1.7 billion of revenue over two years in 1994-95 and 1995-96.<sup>62</sup>

8.102 The Strategy was developed by the ATO within a three week period and presented to the Government on 15 September 1992.<sup>63</sup> Four taxpayer segments were identified in the Strategy:

- . large/medium business;
- . small business;
- . non-business individuals; and
- . special audit (criminal activities).

8.103 For each segment, the Strategy provides a description of:

- . the taxpayer segment;
- . broad approaches to compliance in that segment;
- . areas of emphasis for 1992-1995; and
- . proposed enhancement measures.

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62. Australian Taxation Office, *Income Tax Compliance/Enforcement Strategy*, Canberra, 16 September 1992.

63. *ibid.*

## Large/Medium Business Segment

8.104 Enhancement measures for this taxpayer group focused on an extension of the Large Case Audit program from the top 100 companies to the top 600 companies.<sup>64</sup> Additional funding for this segment was to be utilised in the creation of an extra 100 high level technical staff positions to work in support of two programs:

- . an upgraded Rulings Program; and
- . audits of the top 600 companies.

8.105 Essential to these programs was the employment of 'requisite legal, economic and other technical expertise'.<sup>65</sup> However, on several occasions the ATO indicated to the Committee the significant problems that had been experienced in recruiting high level technical staff particularly from the private sector. The Committee therefore concluded that the majority of the 'additional' staff for these tasks would flow from internal promotions within the ATO. The Strategy itself supports this conclusion as it states:

In the main, the ATO has or can develop the people it needs to carry out this high level work. In seeking Government endorsement of its worth, we would stress the limitations imposed by present remuneration and classification systems and seek some relaxation of the tight central controls that inhibit the ATO's ability to move people to SOG(A) and SES levels.<sup>66</sup>

8.106 The Committee could not determine whether the adoption of the Strategy by the Government constituted an implicit acceptance of this request. However, the Committee noted that the ATO was still negotiating classifications with the Department of Finance in June 1993.<sup>67</sup>

8.107 The Committee recognised that several of the functions identified as relevant to this taxpayer segment had been foreshadowed publicly prior to the formal release of the Strategy or derived from recommendations of the Pappas,

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64. *ibid.*, p. 5.

65. *ibid.*, p. 5.

66. *ibid.*, p. 5.

67. Evidence, vol. 5, p. 1540.

Carter, Evans and Koop Report into the Large Case Audit Program.<sup>68</sup> These recommendations included:

- . implementation of a series of auditing arrangements for the top 600 companies; and
- . increasing the level of resources committed to the writing of Income Tax Rulings and Determinations.

8.108 As several of these functions had already been identified, and in some instances already commenced, the Committee was concerned at the potential for overlap in the provision of revenue projections arising from the Strategy and the modernisation program. The Committee has concluded that there is a need for the ATO to quantify additional revenue anticipated from its modernisation program. Recommendations in respect of the revenue, cost and service implications of the Collection Systems Modernisation project are contained in Chapter 7.

8.109 The Committee recommends that:

- . the Australian Taxation Office prepare estimates of possible revenue gains relating to all systems redevelopment proposals which pertain to modernisation developments, including changes to administrative practices and procedures and advise the Government of those estimates.

### Small Business

8.110 In the area of small business, the Committee noted that the Strategy foreshadowed increased revenue returns from improvements in record keeping and information reporting.<sup>69</sup> Through these programs the Strategy sought to address two fundamental areas where the ATO had identified compliance problems. To the extent that the strategy seeks to address issues of compliance through cooperative assistance to taxpayers in general, the Committee supports the proposed programs.

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68. Evidence, vol. 4, p. 1195.

69. Australian Taxation Office, *Income Tax Compliance/Enforcement Strategy*, Canberra, 16 September 1992, p. 9.

8.111 Evidence in respect of the record keeping review program failed to explain entirely the technique that this program would adopt. Described as both a 'new, educative strategy' and a 'program of record-keeping audits',<sup>70</sup> there appeared to be some confusion about the extent to which the Strategy would seek to assist and advise taxpayers and the extent to which audit procedures would be utilised. The significance of the distinction lay in the degree to which the Strategy was revenue driven. A former Commissioner of Taxation described the program in the following terms:

It is essentially a strategy of examining the books and records of businesses, particularly small business, identifying deficiencies, giving advice, to the taxpayers to help them get it right and, in some cases, revisiting those businesses later on to ensure that they have corrected the error of their way.<sup>71</sup>

8.112 To the extent that the program involves audits, the Strategy is an extension of current practice. However, in so far as it aims to provide a service to business taxpayers in preparing accounting and tax records, it represents an important shift towards the assistance function for the ATO. The Committee noted a potential difficulty in implementing the program if, as is indicated by the statement above, there is the possibility of the ATO utilising data gathered during the assistance phase to conduct revenue conscious audits in the future. Such an outcome may lead to less assistance being provided by taxpayers to the ATO in the conduct of record examinations.

8.113 In the Committee's opinion, the goal of this element of the Strategy needs to be clearly enunciated and communicated to the business community. If the program is merely one involving greater numbers of audits and is revenue focused, this should be categorically affirmed. If future compliance is the goal, tactics and strategies should be formulated on this basis. Either way, the Committee considered the co-operation of the business community would be developed and utilised best if that community was explicitly aware of the purposes of the approach proposed by the ATO.

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70. Senate Estimates Committee B, *Additional Information*, vol. 4, November 1992, p. B687; Australian Taxation Office, op. cit., p. 11.

71. Senate Estimates Committee B, op. cit., p. 11.

8.114 The second limb of the Strategy in respect of small business involved an expanded program of information reporting. Implementation of this limb would require legislative change. Legislation specifying the records businesses should keep in order to prepare income tax returns was proposed. Such a prescriptive action is premised upon extensive consultation with the accounting profession and small business organisations.

8.115 Information reporting requirements are expected to extend to areas in which arrangements include:

- . income paid through specified marketing agencies (covering areas of primary production);
- . income for specified services rendered by professionals and other consultants;
- . income of specified commission agents and independent contractors not subject to the Prescribed Payments System; and
- . business licence arrangements.

8.116 The Committee supports the ATO's moves to formalise record keeping requirements in cooperation with taxpayer representatives and expresses the sincere hope that such a review will reduce compliance costs for all taxpayers and not merely add additional administrative burdens to business.

### **Non-business Individuals**

8.117 The Non-business Individuals taxpayer segment covers the vast majority of taxpayers. The ATO recognised that compliance in this segment was generally very high, principally as a result of the systematic approach that has been adopted to collect tax in this segment.<sup>72</sup> The use of withholding taxes and income matching systems has vastly decreased the opportunities for evasion.

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72. Australian Taxation Office, *Income Tax Compliance/Enforcement Strategy*, Canberra, 16 September 1992, p. 13.

8.118 Capital gains tax was recognised by the ATO as a potential risk area for the revenue. Through ignorance of the law rather than deliberate evasion, loss of revenue from the capital gains tax was considered a major problem.<sup>73</sup> Other areas of concern identified by the ATO for this segment included:

- . use of 'independent' contractors to avoid the PAYE provisions;
- . casual/itinerant workers; and
- . substantiation of work-related expenses.<sup>74</sup>

8.119 Strategies identified by the ATO to improve compliance in this segment included the development of an improved income matching system utilising more advanced technology for the processing and analysis of information obtained from relevant sources. Also the ATO planned to step up activity to prevent further leakage from the PAYE system occurring as a result of artificial employment arrangements. In this regard the ATO has signalled its strong intention to push for legislative change to enable the PAYE system to be extended to independent contractor employment arrangements.

## Projected Revenue Gains and Resource Requirements

### Absolute Value of Revenue Collections

8.120 The Committee considered the level of increased revenue projected to be gained from the Strategy and the ATO's estimates of resource requirements for obtaining this revenue.

8.121 The estimated revenue gains were detailed both in the formal Strategy document given to the Government<sup>75</sup> and in additional information provided to Senate Estimates Committee B on 10 November 1992.<sup>76</sup> The estimates were not identical despite the fact that the November estimates were supposed to have been prepared prior to the Strategy's release. Table 8.5 demonstrates the differences.

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73. *ibid.*

74. *ibid.*

75. *ibid.*, p. 21.

76. Australian Senate Estimates Committee B, *Additional Information*, vol. 5, 10 November 1992, p. 51.

**Table 8.5: Estimated Revenue Returns from Compliance Strategy  
1994-95 and 1995-96**

Business Segment	1994-95 (\$m)		1995-96 (\$m)	
	16.9.1992 Strategy	10.11.1992 Estimates	16.9.1992 Strategy	10.11.1992 Estimates
Large/ Medium	250	300	250	300
Small	250	230	350	285
Non-Business	250	280	350	340
<b>Total</b>	<b>750</b>	<b>810</b>	<b>950</b>	<b>925</b>

Sources: Statement on Tax Policy, circulated by the Hon John Dawkins, MP, Treasurer of the Commonwealth of Australia, Canberra, 16 September 1992; Australian Senate Estimates Committee B, *Additional Information*, vol. 5, 10 November 1992, p. 51.

8.122 The ATO explained these variations as a matter of simple rounding.<sup>77</sup> However, as can be seen from Table 8.5, there was a significant change in the bottomline estimate of revenue to be collected.

8.123 As the information contained in the statement to the Parliament and the additional information provided to the Senate Estimates Committee were not equivalent, the Committee could not satisfy itself of which estimates of revenue were correct. The Committee determined that the differences in the estimates reflected the amount of time which had been available to the ATO to prepare its estimates in September 1992.

#### **Basis of Revenue Collection**

8.124 No explanation of the basis of the revenue estimates were provided in the Strategy. The assumption contained in the Strategy was that an increase in voluntary compliance would produce increases in revenue.<sup>78</sup> No evidence of current voluntary compliance levels were presented by the ATO. The basis of the estimates was said to be from audits in these areas.<sup>79</sup>

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77. Evidence, vol. 5, p. 1543.

78. Senate Estimates Committee B, op. cit.

79. *ibid.*

8.125 The Committee noted that no evidence to support the assumption of increased compliance and its linkage to given levels of revenue increase was provided in the Strategy. Furthermore, the Committee considered comments from the Australian National Audit Office (ANAO) on the revenue implications of compliance levels to be instructive:

It is not possible to assess the quantitative impact of non-compliance. ... The ANAO does not under-estimate the degree of difficulty in measuring the loss of revenue from non-compliance and recognises that it may be difficult to arrive at an estimate which is supportable.<sup>80</sup>

8.126 While the Committee acknowledged that increased compliance was likely to result from a more conspicuous public profile by the ATO both through audit activity and public education, it concluded that, in the absence of objective data, estimates of revenue increases derived from improved taxpayer compliance were purely speculative and as a method of estimating revenue was theoretically unsound.

### Revenue by Segment

8.127 Tables 8.6, 8.7 and 8.8 demonstrate the estimates of increased revenue forecast in the Strategy from the various strategies detailed.

**Table 8.6: Large Business Segment - Estimates of Increased Revenue**

Large/Medium Business (Turnover > \$5m)	1994-95 (\$m)	1995-96 (\$m)
Enhanced Rulings	200	200
Expanded Complex Audit activity	50	50
Expanded 'Business Audit' activity	50	50

Source: Australian Senate Estimates Committee B, *Additional Information*, vol. 5, 10 November 1992, p. 51.

80. Joint Committee of Public Accounts, *Review of Auditor-General's Reports, 1989-90 and 1990-91*, Submissions Volume 6, p. S1323.

**Table 8.7: Small Business Segment - Estimates of Increased Revenue**

Small Business (Turnover < \$5m)	1994-95 (\$m)	1995-96 (\$m)
Record Keeping reviews	115	170
New Information reporting	100	100
Expanded Business Audit	15	15

Source: Australian Senate Estimates Committee B, *Additional Information*, vol. 5, 10 November 1992, p. 51.

**Table 8.8: Non-Business Individuals - Estimates of Increased Revenue**

Non-business Individuals	1994-95 (\$m)	1995-96 (\$m)
Enhanced Income Matching System	180	240
PAYE leakage enforcement	100	100

Source: Australian Senate Estimates Committee B, *Additional Information*, vol. 5, 10 November 1992, p. 51.

8.128 In both 1994-95 and 1995-96 more than 50% of the estimated increased revenue is expected to be raised as a result of improved taxpayer compliance. In respect of non-business individuals, additional revenue is anticipated to flow from an increase in cases of income understatement identified by the income matching system. The ATO indicated that, while it had identified a functional requirement for better income matching, it was not certain how to actually achieve that goal.

8.129 Given that the full extent of the functionality requirements had not been completed when the Strategy was announced, it was surprising that the ATO had been able to determine potential revenue increases. No evidence concerning how the revenue estimates were prepared was available as the ATO had yet to complete a Request for Tender document in which the specifications for the computer

hardware would be provided.<sup>81</sup> In the absence of details allowing the preparation of such a document, the Committee concluded that the full extent of the potential revenue increases could not be reasonably determined. Moreover, the Committee could not determine, on the evidence available, why there was a projected \$60 million increase in revenue from this measure in 1995-96.

8.130 The Committee has concluded that the revenue estimates contained in the Strategy cannot be verified independently. The Committee has further concluded that the ATO should seek to measure the impact of the Strategy on taxpayer behaviour and revenue outcomes and report to the Parliament the outcome of the Strategy in its 1994-95 and 1995-96 Annual Reports.

8.131 The Committee recommends that:

the Australian Taxation Office develop a means for measuring the revenue impact of the Income Tax Compliance/Enforcement Strategy and report to the Parliament on the Strategy's outcomes in the Commissioner's 1994-95 and 1995-96 Annual Reports.

### Resources for the Strategy

8.132 An amount of \$114.5 million was allocated to the ATO for the purpose of implementing the Strategy. In addition, the ATO proposed to bring forward spending under the modernisation program to purchase the necessary technology for improved income matching. The allocation was spread over three years, commencing in 1993-94. An additional 630 ASL positions were to be funded by this allocation. Nearly 70% of the additional positions was projected to be created for the strategies associated with the small business segment.

8.133 The Committee noted that the funding provided to the ATO would not necessarily lead to new staff being employed by the ATO. Indeed, in evidence the ATO indicated that it was possible only 200 new recruits would actually be taken on.<sup>82</sup> The additional 430 positions would be filled by staff already in the ATO. In effect, officers would transfer in their functions or be promoted to new functions. Whether or not the function previously performed would continue to be performed was unclear.

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81. Senate Estimates Committee B, op. cit., p. B680.

82. Evidence, vol. 5, p. 1541.

8.134 The Committee has concluded that, until a merit selection process has been finalised for all positions created to perform the functions of the Strategy, it is not possible to ascertain the net impact on the ATO's staffing. Nevertheless, in view of the fact that the additional staff positions represent approximately 3.5% of the ATO's total staff resource, the Committee concluded that details on the staffing issue should be included in the ATO's report to the Parliament on the Strategy mentioned above at paragraph 8.131.

8.135 The Committee recommends that:

the Australian Taxation Office include in the Commissioner's Annual Report, staffing information in respect of the Income Tax Compliance/Enforcement Strategy and, in particular, report information on the number of staff positions created and the number of positions filled by applicants from outside the Office.

#### Special Audit (Criminal Activities)

8.136 The final limb of the Strategy involved an increase in resources for the Special Audit Program of the ATO. This Program focuses on those persons engaged in criminal business pursuits generating high income, and high profile persons who for various reasons attract the interest of law enforcement agencies or, because of their status and possible criminal business connections, merit special attention.<sup>83</sup>

8.137 From the documentation provided in the Strategy, the Committee could not determine exactly what additional functions the increased staffing resources in this area would perform. Indeed, the information provided suggested that the resources were for additional activity and not related to new functions.

8.138 The Committee was concerned at the apparent revenue 'bonus' that these resources were expected to produce and the failure of the ATO to bring this issue to the attention of Government previously. The audit return on invested resources is projected to be in the order of 20:1, which is double the usual audit return. The Committee was also concerned that the ATO had not specified any functions the additional staff would perform which were in any way different from those functions currently performed. Strategies based on simple propositions of additional resources producing additional returns were considered unacceptable.

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83. Australian Taxation Office, op. cit., p. 18.

8.139 Reflecting upon the development and substance of the Strategy, the Committee was struck by its eminently supportable conclusions. For a sizeable investment the Government was anticipated to receive a return far in excess of that which could normally be expected from the allocation of resources to the ATO. While the Committee was concerned at the reliability of many of the assumptions contained in the Strategy, it noted the enthusiastic support given to the Strategy by the Government. The failure of the ATO to propose such a Strategy to the Government in the lead up to the 1992 Budget was therefore surprising. The Committee considers the ATO should continue to brief the Government regularly on the possibilities for increased revenue activities through compliance and believes its recommendations in respect of reports on the Strategy should form the basis of an on-going, public discussion of compliance issues.

## **The ATO and the Department of Finance**

8.140 Supervision of the ATO's resources by the Department of Finance has been reduced significantly as a result of the APS financial management reforms of the 1980s. In aggregate, these reforms have reduced the Department's role in supervising the daily operations of the ATO and, in particular, the resource allocation decisions of ATO management. The Department of Finance's current role is generally limited to the supervision and evaluation of global issues of outcome rather than the more detailed issues of inputs.

8.141 The Department's role in respect of the ATO is not generally different from the role it has in respect of any other Government agency or department. Perhaps the only significant difference lies in the role the Department of Finance has in monitoring the modernisation program pursuant to the resource agreement for modernisation between the ATO and the Government which is discussed in Chapter 7.

8.142 During the Inquiry, a Department of Finance representative expressed the following views concerning the financial management of the ATO:

My feeling is, certainly in the reporting area, that the Taxation Office has behaved at quite high levels of accountability and responsibility. It has been quite forthcoming, in terms of explanations of what it has done and how it is doing it, and the way in which funds appropriated have been spent. I am aware of nothing that would give us concern that appropriate management practices have not been instituted or that there are problems with their accounting systems per se.

... The Tax Office is going through a period of significant change, as you are aware, due to the public sector reforms, changes in tax policy and strategy and a whole range of initiatives that they themselves have introduced. It is a progressive organisation which has done much, particularly over the last five years, to change the Tax Office of the early 1980s. ... I think the ATO is progressive and it is trying to change the nature and the culture of the Tax Office.<sup>84</sup>

8.143 As is true for any other agency, the capacity of the Department of Finance to comment on and evaluate program proposals from the ATO is limited by the information available to the officers of the Department of Finance and the skills of those officers. The Committee considered this capacity is currently restrained by the extent of the knowledge of operations and culture of the ATO held by officers of the Department of Finance. The Committee considered both the ATO and the Department of Finance would benefit if officers of both agencies were able to appreciate the operations of each other, on an on-going basis.

8.144 To this end, the Committee recommends that:

**the Australian Taxation Office and the Department of Finance establish a reciprocal program of officer interchange.**

8.145 The reciprocal movement of ATO officers from the ATO's Corporate Services Group to the Department of Finance would further advance the understanding between the organisations. It would be necessary that the ATO officer not work in the area of the Department dealing with the ATO. However, the officer should be given experience in the budget and evaluation work of the Department of Finance.

8.146 This program of interchange should be formal and made a regular feature of the interaction between the two agencies. The level of the officers involved in the interchange should be determined by the skill level of the tasks it is proposed the relevant officers should perform. However, for the program to achieve its objective of providing a better understanding of the role of the respective organisations, the officers should be of sufficient standing as to be involved in managing the inter-relationship of the organisations on a regular basis.

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84. Evidence, vol. 2, p. 641.

8.147 Given the limited number of officers within the Department of Finance who work directly on the programs of the ATO, the Committee considers it imperative that such officers have regular practical contact with the work environment of ATO staff.<sup>85</sup> While officers in the Supply areas of the Department of Finance may not require a detailed knowledge of practical applications for budgetary purposes, the increasingly important function of program review does require such an understanding. Attempting to gain such knowledge from the occasional 'review' is considered to be inefficient and a greater familiarity with ATO practices would, in the Committee's view, improve the efficiency of both the ATO and the Department of Finance.

8.148 The Committee recommends that:

the Department of Finance allocate sufficient resources to allow officers, who have regular dealings with resource issues affecting the Australian Taxation Office, to visit and inspect the operations of an Australian Taxation Office branch office at least once a year.

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85. Evidence, vol. 3, pp. 636-7.

**PART 2 - ATO OPERATIONS AND  
TAXPAYERS**

**CHAPTER 9 Revenue Collection**

**CHAPTER 10 Taxpayers Assistance**

**CHAPTER 11 Auditing**

**CHAPTER 12 Enforcement and Penalties**



## Chapter 9

### REVENUE COLLECTION

- . The Revenue Collection Group
- . Efficiency of Collection
- . Processing Returns
- . Revenue Collection Strategies
- . Revenue Collection Systems
- . Hardship

#### The Revenue Collection Group

9.1 The single most important function of the Australian Taxation Office (ATO) is the collection of the Commonwealth's taxation revenue. Responsibility for the estimation and monitoring of revenue collections, the establishment of taxpayer liabilities, securing lodgement of income tax returns and payment of taxes from non-complying clients belongs to the Revenue Collection Group (the Group). The Group is responsible for providing administrative advice and assistance to taxpayers to enable them to fulfil their obligations under the law and allow the ATO to collect the revenue. The Group employs almost 7 000 staff and utilises nearly 30% of the ATO's salaries budget.<sup>1</sup> Over recent years the numbers of staff employed in the direct revenue collection function has gradually fallen.<sup>2</sup> Factors contributing to the staffing of the Revenue Collection Group include:

- . the development of modernised computer facilities that have allowed staff resources to be moved from processing work;
- . an increase in the use of withholding taxes;
- . increases in the number of taxes administered; and
- . the need to reduce outstanding debt levels.

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1. Evidence, vol. 4, pp. S925, S933.

2. Evidence, vol.4, p. S934.

9.2 The processing nature of much of the revenue collection workload is indicated by the distribution of running cost resources within the ATO. Hence, while the Revenue Collection Group employs nearly 75% more staff than the next largest Group (Taxpayer Audit), it utilises only 28% of the salary budget compared to the Taxpayer Audit Group's 23%. This indicates a relative staff distribution skew within the Revenue Collection Group towards lower classified staff.

9.3 According to the ATO, the Revenue Collection Group aims to maximise revenue and minimise the cost of collections by estimating revenue, making collections, establishing client identity and providing services which enable the Group to collect revenue for the Government at minimum cost.<sup>3</sup>

9.4 The Group is headed by a National Program Manager (First Assistant Commissioner) and, in addition to its revenue collection function, is responsible for six major modernisation projects:

- . Collection Systems Modernisation;
- . Income Tax Modernisation;
- . Electronic Lodgement Service (ELS);
- . Automated Data Capture;
- . Automated Document Dispatch (ADD); and
- . Storage and Access.<sup>4</sup>

9.5 Successful revenue collection relies upon a number of technical and practical strategies which when taken together provide a framework for the compulsory collection of tax obligations. In assessing the success of these strategies, a number of possible measures have been proposed.

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3. Evidence, vol. 4, p. S870.

4. *ibid.*

9.6 The ATO has set for itself at least two standards by which it believes its revenue collection efficiency should be judged. In its submission to the Inquiry the ATO stated:

For a revenue collection agency, we consider two approaches to measuring effectiveness stand out as the most obvious -

- (i) the extent to which the revenues budgeted (where based on economic and other factors) are actually collected; and/or
- (ii) the extent to which the total amount of tax correctly payable (ie. where all income is properly declared and only legal deductions claimed) is in fact collected. (The difference between the total tax correctly payable and actual receipts, is often referred to in tax literature as the 'tax gap').<sup>5</sup>

9.7 A third possible indicator of efficiency is the cost of collecting revenue as a proportion of total revenue collections. Also relevant as an indication of the performance of the Group is efficiency and effectiveness in its processing of taxpayer returns.

9.8 The Committee noted the suggestion that neither of the ATO's standards could be considered perfect as they suffered from inherent measurement and practical difficulties.<sup>6</sup> While acknowledging these limitations the Committee considered that the several performance standards, when taken together, provided a general basis for evaluation of the efficiency of revenue collection practices.

9.9 While total taxation revenue collections are influenced by many factors, including domestic and international economic growth, employment conditions, inflation, the mix of taxation, compliance by taxpayers and even the weather, the total revenue figure is indicative of the importance of good revenue collection practices within the ATO. Table 9.1 illustrates the growth in total revenue collections over the past three decades.

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5. Evidence, vol. 4, p. S731.

6. *ibid.*

**Table 9.1: Revenue Collection by the Australian Taxation Office  
1960-61 to 1989-90**

Year	Amount (\$'000)	Year	Amount (\$'000)	Year	Amount (\$'000)
1960-61	2 129 594	1970-71	5 603 852	1980-81	24 683 573
1961-62	2 128 523	1971-72	6 129 146	1981-82	29 519 335
1962-63	2 118 060	1972-73	6 585 229	1982-83	31 788 898
1963-64	2 399 481	1973-74	8 626 190	1983-84	34 221 447
1964-65	2 882 137	1974-75	11 502 845	1984-85	40 750 127
1965-66	3 148 569	1975-76	13 469 278	1985-86	45 659 203
1966-67	3 355 650	1976-77	15 886 892	1986-87	52 932 000
1967-68	3 729 886	1977-78	17 345 853	1987-88	60 170 000
1968-69	4 218 728	1978-79	17 935 485	1988-89	69 338 000
1969-70	4 964 950	1979-80	20 651 072	1989-90	75 983 000

Source: Commissioner of Taxation, *Annual Report*, 1968-69 to 1989-90

9.10 Comparative figures for the past three financial years are as follows:

<u>Year</u>	<u>Amount (\$'000)</u>
1990-91	77,476,000
1991-92	73,421,000
1992-93	74,712,000 <sup>7</sup>

9.11 Revenue collections rose in real terms by 36% between 1983-84 and 1992-93. This represents an annual average growth of 3.6% over the ten year period. Table 9.2 illustrates the change in collections for the past ten years.

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7. Evidence, vol. 22, p. S5332.

**Table 9.2: Real Percentage Change in Revenue Collection  
1983-84 to 1992-93**

Year	% Change on previous year
1983-84	+ 0.87%
1984-85	+ 12.34%
1985-86	+ 4.5%
1986-87	+ 7.82%
1987-88	+ 6.61%
1988-89	+ 6.42%
1989-90	+ 3.12%
1990-91	- 2.05%
1991-92	- 6.67%
1992-93	+ 0.81%

Sources: Calculated from data in Commissioner of Taxation,  
*Annual Report 1968-69 to 1991-92, Evidence, vol. 22,*  
p. S5332.

9.12 Table 9.1 demonstrates the remarkable growth in revenue collections in the past three decades: during the 1960s revenue collections grew in absolute terms by 133%; by 269% in the 1970s; and by 208% during the 1980s. However, Table 9.2 also clearly demonstrates the decline in revenue growth since 1987-88 and the negative revenue outcome during the current recession. The growth in revenue can be compared with the net cost of collecting that revenue. The cost of collections, expressed as a percentage of revenue collected, is set out in Table 9.3 and illustrates the percentage of the revenue that is allocated to the very act of revenue collection.

**Table 9.3: Cost of Collections as a Percentage of Revenue Collected  
1960-61 to 1989-90**

Year	Percentage	Year	Percentage	Year	Percentage
1960-61	0.955	1970-71	0.992	1980-81	0.889
1961-62	1.018	1971-72	1.046	1981-82	0.897
1962-63	1.071	1972-73	1.101	1982-83	0.938
1963-64	1.055	1973-74	1.024	1983-84	1.032
1964-65	0.949	1974-75	0.986	1984-85	1.011
1965-66	0.960	1975-76	0.980	1985-86	1.069
1966-67	1.072	1976-77	0.958	1986-87	1.061
1967-68	1.044	1977-78	0.941	1987-88	1.030
1968-69	0.998	1978-79	0.974	1988-89	1.033
1969-70	0.989	1979-80	0.925	1989-90	1.087

Source: Commissioner of Taxation, *Annual Reports 1969-70*, p. 18; Commissioner of Taxation, *Annual Report 1979-80*, p. 60; Evidence, vol. 22, p. S5123.

9.13 For the past three years the comparative figures have been:

<u>Year</u>	<u>Percentage</u>
1990-91	1.144%
1991-92	1.261% <sup>8</sup>
1992-93	1.254% <sup>9</sup>

9.14 The ATO identified eight factors affecting the costs of collection ratio over the recent years:

- . the overall reduction in the tax scales for both company and personal taxes;
- . the introduction of significant tax reform packages;

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8. Evidence, vol. 22, p. S5123.

9. Evidence, vol. 22, p. S5332.

- . the funding of increased levels of audit activity;
- . the introduction of interest on overpayments in 1983-84;
- . the recession;
- . accommodation costs associated with the decentralisation program;
- . the reflection of actual as opposed to notional costs of accommodation as the result of the transfer of budget responsibility from the Department of Administrative Services to other Government departments in 1989-90; and
- . the influence of the modernisation program from 1989-90.<sup>10</sup>

9.15 The ATO advised the Committee that it anticipated the costs of collection to fall as revenue increased and the results of one off investment in future efficiency began to take effect.<sup>11</sup> While the Committee acknowledged the impact of the factors identified by the ATO upon the cost of collections, it was also cognisant of the historically high cost of revenue collection in recent years. In contrast to the previous two decades where the cost of collection exceeded 1% in eight out of the twenty years, the cost of collection has not fallen below 1% for the past ten years.

9.16 The Committee also concluded that efficiencies deriving from the recent investment in the ATO should allow the cost of collection to fall and remain below 1% by the middle of the decade. In the Committee's opinion the ATO should aim to reduce the cost of collection to below 1% within two to three years. In achieving such a goal the Committee considers it imperative the ATO ensure that its own collection cost is not reduced at the expense of an increase in compliance costs to taxpayers.

9.17 **The Committee recommends that:**

- . **the Australian Taxation Office set for itself a performance target of reducing the cost of collection to less than one percent of annual revenue collected by 1995-96.**

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10. Evidence, vol. 22, p. S5119.

11. Evidence, vol. 22, pp. S5120-1; vol. 4, S735.

## Efficiency of Collection

9.18 The first measure proposed by the ATO for assessment of its revenue collection efficiency related to the success of collecting budgeted revenue.

9.19 Table 9.4 illustrates the ATO's success in estimating revenue collections during the 1980s. The various success rates are important for several reasons but most significantly because the estimates of the ATO are utilised by the Government in forecasting the Budget surplus/deficit. As such, these forecasts have an impact upon financial markets in their assessment of the likely call by the Commonwealth on borrowings which thus impact on the level of interest rates.

**Table 9.4: Change in Actual Collections over Budget Forecasts  
1980-81 to 1992-93**

Year	Percentage Difference	Year	Percentage Difference	Year	Percentage Difference
1980-81	+ 3.0	1985-86	- 1.1	1990-91	- 3.5
1981-82	+ 0.7	1986-87	+ 2.2	1991-92	- 4.4
1982-83	- 2.9	1987-88	+ 4.2	1992-93	- 1.2
1983-84	+ 0.7	1988-89	+ 1.2		
1984-85	- 1.8	1989-90	- 0.6		

Sources: Commissioner of Taxation, *Annual Reports 1981-82 to 1991-92*, Evidence, vol. 4, p. S5332.

9.20 Revenue collections for the past three financial years have been under Budget estimates by the following amounts:

<u>Year</u>	<u>Revenue Shortfall (\$bn)</u>
1990-91	\$2.800
1991-92	\$3.351
1992-93	\$0.898 <sup>12</sup>

12. Evidence, vol. 4, p. S5332.

9.21 By any measure, this underestimate has been significant. As previously noted, the consequence of this failing is to undermine the basis upon which governments determine expenditure plans and set macro economic parameters. Such outcomes can be mitigated through regular reviews and analysis of revenue collections, actual outcomes and forecasts.

9.22 Under current arrangements, the Revenue Analysis Branch of the ATO, in consultation with the Treasury, is responsible for providing revenue estimates to the Government.<sup>13</sup> Models of each head of revenue have been developed within the ATO. Each model is constructed in such a way as to react to changes in economic indicators and exogenous factors such as legislative amendments. The majority of the economic indicators, and certainly the most significant, are provided by the Joint Economic Forecasting Group through the Commonwealth Treasury.<sup>14</sup> Information from confidential surveys of large companies is also fed into the models.<sup>15</sup> More specific ATO data may be substituted for general information as it becomes available.

9.23 As the economic indicators provided by the Joint Economic Forecasting Group are revised, new parameters are determined for the models and the revenue estimates are revised. These revisions are aligned to the release of the National Accounts data, released by the Australian Bureau of Statistics (ABS), in October, January and April each year.<sup>16</sup> A revenue estimate is prepared by the ATO in February and May.<sup>17</sup>

9.24 Dependence upon broad economic measures of activity for the establishment of the essential parameters of the ATO's revenue models has proven to be a drawback during the most recent economic downturn. Failure to accurately forecast the seriousness of the economy's problems has resulted, in part, in the Government establishing expenditure programs in expectation of revenue collections that have failed to materialise.

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13. Evidence, vol. 16, p. S3261.

14. Evidence, vol. 16, p. S3262.

15. Commissioner of Taxation, *Annual Report 1991-92*, AGPS, Canberra, 1992, p. 18.

16. Evidence, vol. 16, p. S3262.

17. Evidence, vol. 9, p. 1482.

9.25 The Committee noted that the ATO was looking at alternative sources of information on which to base revenue estimates. While the Committee does not believe the ATO has a realistic alternative source of general forecast data outside of the ABS and Treasury, it considers the ATO has the capacity to develop complementary revenue models which draw more critically upon taxpayer profiling and taxpayer segmentation. Through such models, relative changes in taxpayer behaviour and experience, particularly in relation to economic circumstances, should indicate more pragmatic conclusions in respect of economic conditions. This information should be deliberately drawn upon to provide and monitor revenue collection forecasts.

9.26 The failure of the ATO to accurately assess the depth of the economic recession in Australia in the past three years indicates to the Committee a need to revise the current modelling process. Not only is the current model patently inadequate, but the timing and frequency of statistical releases needs to be reviewed. The ATO must be able to better identify significant changes to the forecast pattern of revenue collection.

9.27 The Committee recommends that:

- . the Australian Taxation Office review its current revenue forecasting models in consultation with the Treasury, Australian Bureau of Statistics and other forecasting agencies; and
- . the Australian Taxation Office seek to develop an on-going modelling capacity which can provide Government with predictions of monthly revenue collections and an early warning mechanism in the event of significant changes to the forecast pattern of revenue collection.

9.28 The second measure of revenue efficiency proposed by the ATO relates to what is commonly known as the 'tax gap', that is, the difference between the legally due level of revenue and the actual level collected. As the ATO was not able to calculate a number of the elements of the theoretical tax pool and instead preferred to obtain reliable, timely estimates of taxpayer compliance with respect to key income streams, industries and occupations, the Committee was unable to evaluate the ATO's performance against this criteria.

9.29            However, the Committee noted the lack of substantive evidence to support contentions of compliance levels. As mentioned in Chapter 8, the Committee considered as 'guesstimates' proposed additional revenue collections based on improved compliance behaviour by taxpayers where no evidence of the level of actual or existing behaviour was provided. The Committee has concluded that the ATO should not make assertions concerning increases in revenue from increased compliance if it can not substantiate current compliance percentages.

## **Processing Returns**

9.30            Over recent years, taxpayers have tended to evaluate the efficiency of the ATO in large measure on the time taken to process their annual returns and to issue, where appropriate, refund cheques. This phenomenon derived from expectations created by the publicity surrounding the Electronic Lodgement Service (ELS) and its capacity to reduce turnaround times for assessments.

9.31            Although the ELS is not designed to collect tax revenue, it plays an integral role in the relationship between the taxpayer, the tax agent where appropriate, and the ATO.

9.32            The performance standard established by the ATO for the ELS was the issue of 80% of assessments within 14 days of receipt of the return. Obviously the 14 day turnaround goal is not achievable for returns which are not routine, for example where there is:

- .            a request for a Ruling;
- .            a previously lodged return in another state;
- .            an unissued or outstanding prior year return;
- .            a case involving provisional tax; or
- .            a duplication of a tax file number.

9.33 Evidence to the Committee, however, indicated that the ELS had consistently performed more efficiently than the performance measure proposed. At the time of the Committee's hearings the ELS was reported to be issuing returns within 14 days in 90-95% of cases.

9.34 In reviewing the processing of taxpayer returns, the Committee was keenly aware of the improvements in productivity that had been achieved as a result of the ELS and the move towards self assessment. The Committee also noted the reduction in staff time spent keying in information. Given the changes that have taken place in processing returns over the past decade, the Committee was unable to determine what proportion of the efficiency gain was due to the productivity of staff vis-a-vis the procedures and technology changes. Notwithstanding this, the Committee acknowledged that there had been a significant improvement in the processing function.

9.35 However, the timely processing of assessments and refunds or debt notices must be compared with the accuracy of the assessments made. The Committee received evidence from taxpayers of errors which had both occurred and recurred in the processing function, apparently as a result of human error.<sup>18</sup> Such failures, though perhaps relatively few in total, present an unfortunate public face for the ATO, particularly when the assessment or notice has been computer generated and the technical error is in the computer program or the printing facility. Such failures reinforce the risk of relying too heavily upon computers and information technology. The Committee considers that, while such errors were perhaps exceptions, the ATO needs to implement schemes to mitigate such events both prior to assessments being issued and in the event of errors occurring.

9.36 The Committee considers the ATO should also review its internal procedures in respect of the keying and checking of information. While administrative efficiency and risk management were recognised by the Committee as sensible criteria for program management, the Committee also considers the ATO needs to evaluate regularly the internal control mechanisms. While not seeking to be definitive, the Committee considers the ATO should monitor and evaluate procedures for the use of duplicate group certificates, and review systems for the automatic identification of unusually large refund or debt notices.

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18. Evidence, vol. 1, p. S81.

9.37

The Committee recommends that:

- . the Australian Taxation Office review its procedures for random examination checking of assessments and notices produced by the Automatic Data Dispatch system for the purpose of ensuring incorrect assessments and notices are not issued; and
- . where an assessment or notice is issued which contains an error produced by either human or computer failure and the taxpayer draws the existence of this error to the attention of the Australian Taxation Office, the taxpayer receive either a discount on the issued debt notice or a bonus on the tax refund.

### Revenue Collection Strategies

9.38 In recent years the ATO has adopted a number of strategies for collecting revenue. They include:

- . providing accurate advice to clients on their obligations under the various tax laws (for example, Taxpack, Group Employers Booklet);
- . achieving timely collection and banking of tax payments;
- . providing a prompt service to clients in the provision of advice and payment of tax refunds;
- . forwarding notifications to clients of tax payments due (for example, through company instalment notices);
- . undertaking timely follow-up action in response to clients who fail to lodge returns or make payments by the relevant due date(s), initiating legal action where appropriate;
- . optimising the use of modern technology in the design of tax administration business systems (for example, Electronic Lodgement Service, Agency Billpay Service);
- . maintaining good consultative arrangements with professional, industry, trade and taxpayer groups; and

monitoring the efficiency and effectiveness of new legislation to identify opportunities to simplify tax laws.<sup>19</sup>

9.39 The Committee noted the systemic approach adopted by the ATO for the collection of revenue and the importance of communication to the successful achievement of the ATO strategies. The Committee has concluded that continued emphasis on involvement of taxpayers in the taxation system and an emphasis on timely, accurate and cooperative service to taxpayers will support the strategies for revenue collection currently utilised by the ATO.

### **Revenue Collection Systems**

9.40 Three principal systems are utilised in the collection of personal income tax in Australia:

- . the Pay-As-You-Earn (PAYE) system;
- . the Prescribed Payments System (PPS); and
- . the Provisional Tax System.

#### **Pay-As-You-Earn**

9.41 The PAYE system was introduced in Australia in 1944-45. Under this system, employers deduct from employee's pay each pay period the equivalent of the employee's taxation liability on that income. Each month the employer remits these amounts to the ATO. The employer maintains and reconciles records in respect of PAYE deductions. Copies of these records are lodged with the ATO. At the end of the financial year the employer issues a group certificate to the employee for the purpose of preparing an annual income tax return.

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19. Evidence, vol. 4, p. S869.

9.42 The PAYE system provides a cash flow benefit to the Government and an administrative convenience to the taxpayer. The benefit of the system to the employer is less clear. The Committee noted with interest the suggestion of one witness that the ATO should compensate employers for the administrative burden of maintaining the system.<sup>20</sup> The point of this 'user pays' principle was not lost on the ATO.<sup>21</sup>

9.43 Over 50% of the ATO's revenue collections are obtained via the PAYE system. PAYE collections for the past four financial years are listed below:

<u>Year</u>	<u>Revenue Collected (\$bn)</u>
1989-90	\$40.222
1990-91	\$39.780
1991-92	\$38.980 <sup>22</sup>
1992-93	\$40.499 <sup>23</sup>

9.44 The decline in net PAYE collections can be attributed primarily to the effects of the economic recession and the decline in PAYE taxpayer numbers.

### **Prescribed Payments System**

9.45 The Prescribed Payments System is akin to the PAYE system in that it deducts taxation obligations at source. The system was introduced primarily to improve compliance in particular sectors of the community in which 'cash in hand' arrangements were considered plentiful and thus tax payments were being avoided. The system is narrowly focused and contributes generally less than 2% of the ATO's total revenue per annum.

### **Provisional Tax System**

9.46 Division 3 of Part VI of the *Income Tax Assessment Act 1936*, establishes a system of provisional taxation. Generally speaking, the provisional tax arrangements seek to impose on taxpayers who earn above a certain level of non-wage or salary income, an obligation to pay tax on that income throughout the year

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20. Evidence, vol. 2, p. 397.

21. Evidence, vol. 4, p. 1447.

22. Commissioner of Taxation, *Annual Report 1991-92*, AGPS, Canberra, 1992.

23. Evidence, vol. 22, p. S5332.

in which the income will be earned. The taxpayer is required to estimate the level of income that will be obtained from these sources, such as interest and dividends, and make quarterly payments of Provisional Tax to the ATO.

9.47 The Committee received evidence of the problems encountered by taxpayers with the operation of the Provisional Tax System, and in particular the administrative arrangements for the computer system and the general reasonableness of the administrative procedures.<sup>24</sup>

9.48 While the Inquiry's terms of reference did not provide for a detailed consideration of the operation of the Provisional Tax System, the Committee considers the system for calculation of provisional tax should be simplified to align the provisional tax system as closely as possible to a PAYE arrangement.

9.49 The Committee recommends that:

**the Government institute amendments to the operation of the Provisional Tax System for the purposes of establishing a simplified administrative system for the calculation of provisional tax.**

#### **Other Collection Approaches**

9.50 The Committee acknowledged the use of a number of broad systematic approaches adopted by the ATO for the collection of revenue. In particular the Committee noted:

- . the Tax File Number (TFN) arrangements;
- . the Higher Education Contribution Scheme (HECS);
- . auto-withholding arrangements for child support;
- . Fringe Benefits Tax and Sales Tax administrative arrangements; and
- . Company Tax Collection and Payment systems.

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24. Evidence, vol. 5, pp. S709-10, 196-9.

9.51 In general the Committee supported the development and implementation of taxation systems which impose and levy tax at source, that is, those systems which deduct income tax at the time of the activity which gives rise to the income being earned.

9.52 A broadening of the system of withholding tax was proposed to the Committee in the submission of the Taxation Institute of Australia.<sup>25</sup> The Institute's proposal for an Australian Resident Withholding Tax sought to:

- . provide incentive to taxpayers to save;
- . streamline tax administration by eliminating as far as possible the need to lodge routine income tax returns;
- . reduce avoidance/evasion opportunities;
- . provide alternative opportunities for wage/tax trade-offs; and
- . improve Government cash flows.

9.53 In the 1992 Commonwealth Budget, the Government announced:

... to maintain the structure of the revenue base and reduce the prospective deficit for 1995-96 the Government is prepared to consider reforms to the domestic interest withholding tax, the scope of the PPS arrangements and the FBT system.<sup>26</sup>

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25. Evidence, vol. 5, p. S796.

26. Budget Statements 1992-93, Budget Paper No. 1 AGPS, p. 4.41.

9.54 The Budget was delivered on 18 August 1992. In a confidential memorandum 15 September 1992, the then Commissioner advised the Treasurer of a general point earlier in the year concerning the deduction of tax at source as the most efficient and effective means of gathering tax. However, he currently did:

... not recommend any extension of the deduction-at-source system, either by way of a domestic interest withholding tax or extension of the prescribed payments system'.<sup>27</sup>

9.55 It was further suggested that some extension of the TFN arrangements, could be very valuable in securing compliance, thus obviating the need for further deduction-at-source arrangements.

9.56 During the Committee's hearings, the then Commissioner indicated that the issue was the subject of a current policy debate.<sup>28</sup> At a more theoretical level he acknowledged that, in his opinion, deduction at source was the most efficient and effective means of gathering tax.<sup>29</sup> He added that arrangements for further deduction at source taxes were possible but would need to be considered in the context of many issues.<sup>30</sup>

9.57 Consideration of issues of legislative change, as would be necessary for a resident withholding tax, are beyond the terms of reference of this Inquiry. The Committee noted however the potential benefits of withholding taxes as methods of revenue collection.

9.58 Also in the context of efficiently taxing particular entities, the Committee was provided with evidence supporting the taxation of trusts in the same manner as corporate entities, including the provision of a rebate to beneficiaries.<sup>31</sup> The Committee noted that a recommendation to this effect had been made by the

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27. Confidential Minute from Commissioner of Taxation to the Treasurer, 15 September 1992, Tabled in the House of Representatives on 16 September 1992.

28. Evidence, vol. 8, pp. S1206-9.

29. Evidence, vol. 4, p. 1204.

30. Evidence, vol. 4, p. 1207.

31. Evidence, vol. 3, p. 694.

House of Representatives Standing Committee on Finance and Public Administration in March 1991.<sup>32</sup> The Government has yet to respond formally to this recommendation.

### Debt Collection

9.59 A further approach to the objective of revenue collection consists of strategies designed to manage debt collection. The Commissioner's Annual Report of 1991-92 details a number of strategic objectives including the implementation of strategies to reduce in real terms the number of debt management cases existing at the end of each financial year.<sup>33</sup>

9.60 A number of possible measures can be used to evaluate the efficiency of the ATO's debt management program. As mentioned above the number of cases existing at the end of a financial year is one measure. However, rigid pursuance of such an objective may impact on the number of cases of hardship experienced by taxpayers. (This is discussed in paragraph 9.91.) The Committee considered two measures to be of greater significance:

- . the value of unpaid tax at the end of the financial year; and
- . the amount of tax unpaid as a percentage of total tax.

9.61 Tables 9.5 and 9.6 indicate the performance of the debt management program against these criteria for the past five years.

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32. House of Representatives Standing Committee on Finance and Public Administration, *Follow the Yellow Brick Road, The Final Report on An Efficiency Audit of the Australia Taxation Office: International Profit Shifting*, AGPS, Canberra, March 1991, p. 34.

33. Commissioner of Taxation, *Annual Report 1991-92*, AGPS, Canberra, p. 19.

**Table 9.5: Unpaid Income Tax at 30 June, 1988-89 to 1992-93**

Year	Amount (\$bn)
1988-89	2.73
1989-90	3.47
1990-91	3.62
1991-92	3.35
1992-93	2.89

Sources: Commissioner of Taxation, *Annual Report* 1990-91; 1991-92; Evidence, vol. 22, p. S5332.

**Table 9.6: Percentage of Tax Unpaid to Total Tax for Individuals, Companies and Trusts 1988-89 to 1992-93**

Year	Percentage
1988-89	13.2
1989-90	14.2
1990-91	13.5
1991-92	18.6
1992-93	18.1

Sources: Commissioner of Taxation, *Annual Report* 1991-92; Evidence, vol. 22, pp. S5332-3.

1989-90 to 1992-93

9.62 Debt collection is the responsibility of staff of the Debt Collection Sections of each branch office of the ATO. An outstanding debt may be defined as an amount of tax due and payable by law which has not been received by the ATO within the statutory time established for its payment and in respect of which no extension of time in which the debt may be paid has been granted. Debt Collection Sections attempt to collect debts in respect of a range of taxes including:

- . income taxes;
- . sales taxes;
- . the Medicare Levy;

- . wool tax;
- . recoupment taxes;
- . Fringe Benefits Tax; and
- . withholding taxes.

9.63 The Committee noted that the ATO had moved during 1986-87 to introduce a debt write-off policy based on commercial practices.<sup>34</sup> As a consequence, there was a very significant increase in the level of tax debt written off in that year and for subsequent years. It should be noted, however, that the absolute amount written off in 1987-88 and 1988-89 was determined significantly by the write-off of amounts in relation to company strip assets where the company was found to have no assets, where tax imposed was not collectable under recoupment tax legislation or where an assessment was raised using an alternative basis.<sup>35</sup>

9.64 Each Debt Collection Section is structured to include a Liquidations Sub-section which manages tax debts in respect of insolvencies. Prior to 1987-88, the ATO would not write off the non collectable portion of tax in an insolvency case until advice of a final dividend had been received. Since that year, the non collectable portion of the debt has been written off whilst the administration of the insolvency matter is being conducted.<sup>36</sup>

9.65 ATO principles for debt collection seek a balance between commercial reality and statutory responsibility. Section 70C of the *Audit Act 1901* provides the legal authority to the Minister for Finance to write-off Commonwealth debts. The section, in part reads:

70C (1) The Minister shall have, and shall be deemed at all times to have had, power to write off -

- (a) losses or deficiencies of public moneys;
- (b) irrecoverable amounts of revenue;

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34. Commissioner of Taxation, *Annual Report 1986-87*, AGPS, Canberra, 1987, p. 15.  
 35. *ibid.*, p. 53.  
 36. *ibid.*

- (c) irrecoverable debts and overpayments; and
- (d) the value of lost, deficient, condemned, unserviceable or obsolete stores.

9.66  
12 years.

Table 9.7 demonstrates the amount of tax written off over the past

**Table 9.7: Tax Debt Written Off under Section 70C of the *Audit Act 1901*, 1981-82 to 1992-93**

Year	Tax Written Off (\$m)
1981-82	11.3
1982-83	8.2
1983-84	11.2
1984-85	30.2
1985-86	91.5
1986-87	163.2
1987-88	651.5
1988-89	881.6
1989-90	363.1
1990-91	365.3
1991-92	666.3
1992-93	690.6

Sources: Commissioner of Taxation, *Annual Report 1982-83 to 1991-92*; Evidence, vol. 22, p. S5333.

9.67 The Committee considered the debt collection procedures from first principles. A debt due and payable to the Commonwealth should be collected. Such a principle, however, must be subject to certain resource constraints which imply for the collecting agency a commercial prerogative to determine those debts which are economically recoverable. At the same time the best interests of the taxation system are served by a public perception that no taxpayer can evade the payment of a legal debt by virtue of the ATO's incapacity to action recovery.

9.68 The Committee noted criticism by the Auditor-General of the ATO's management of the debt collection function.<sup>37</sup> These criticisms concentrated on the inequitable and uneven handling of debts by various branch offices. The Committee was particularly concerned at suggestions of an inconsistent approach in branch offices to the write-off of debts. The ATO claimed these problems stemmed from a lack of available staff and noted that new computerised systems allowed staff to be transferred quickly to work on debt collection and the identification of new debts.<sup>38</sup>

9.69 The Committee concluded that the debt collection function should, to the greatest extent possible, seek to recover or action recovery each all case where an outstanding taxation debt exists. Nevertheless, the Committee recognised the commercial reality of debt collection and considered it appropriate for the ATO to set a national policy on debt collection. Such a policy should be capable of consistent application across Australia.

9.70 The Committee noted the adoption over recent years of procedures by the Debt Collection Sections to streamline the collection of debt, including:

- . negotiation and settlement;
- . the development of commercial payment arrangements;
- . the publication of information brochures for taxpayers having payment difficulties;
- . the use of the full range of legal processes, including bankruptcy and liquidation action;
- . the use of instant contact (via telephone) procedures; and
- . the development of a Technical Recovery Advisory Committee to monitor complex legal matters relating to debt collection.

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37. The Auditor-General. Audit Report No. 33 1991-92, *Efficiency Audit - Australian Taxation Office - Administration of Fringe Benefits Tax*, AGPS, Canberra, p. 65.

38. Commissioner of Taxation, *Annual Report 1991-92*, AGPS, Canberra, 1992, p. 23.

9.77 The ATO later claimed in an analysis of the Report that:

- . a significant portion of the growth in collections of FBT had been achieved over and above the effects of inflation and salary packaging; and
- . a very high level of compliance with FBT (over 90%) was being achieved.<sup>43</sup>

9.78 In defence of his Report, the Auditor-General responded that the ATO had misrepresented the ANAO<sup>44</sup> and, in administering the FBT was advocating short term sacrifices in revenue collection in the interests of modernisation. If this were so, he argued, 'the ATO should attempt to quantify the revenue foregone as part of the cost of modernisation and communicate relevant details to the Parliament'.<sup>45</sup>

9.79 As the Committee noted in 1987 in its Report 287,<sup>46</sup> the ATO had no real alternative other than to invest in a technological upgrade of its computer facilities. This upgrade was always intended to involve a much broader reorganisation of the ATO. In this context, the evolutionary process of change within the ATO has been planned and managed. The Committee does not resile from its position in 1987 concerning the need for, and the desirability of, change in the ATO. Nevertheless, the ATO's statutory role both now and in the future is the collection of revenue. Any failure to collect that revenue must be allocated a cost and explained in terms of Government priorities or environmental factors which make its collection impossible. In the Committee's opinion, it is not for the ATO to determine that a revenue shall not be collected. Constitutionally, that is the role of the Parliament, which establishes the laws by which taxation obligations are imposed, and the Government, which establishes administrative priorities.

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43. Evidence, vol. 18, p. S4032.

44. Evidence, vol. 13, p. S2438.

45. Evidence, vol. 13, p. S2439.

46. Joint Committee of Public Accounts, *Australian Taxation Office -Computer Systems Re-Equipment and Redevelopment*, Report 287, AGPS, Canberra, 1987.

9.80 In the Committee's view, there were two primary issues of dispute between the ATO and ANAO in respect of the Auditor-General's Report No. 33 of 1991-92 that were relevant to the Committee's Inquiry. The first related to the priority afforded to collection of FBT debts by the ATO and the size of the loss of revenue which was being incurred as a result of the ATO's practices. The second question related to the degree to which increased levels of FBT revenue could be related to increased efficiency of administration.

9.81 As to the first issue, information provided by the ATO and the ANAO indicated that not all FBT debts were collected. There was no disagreement on this point. What was at issue was the relative and potential size of the gap between what could have been and what was collected.

9.82 After considering the submissions of both the ATO and the ANAO, the Committee concluded there had not yet been sufficient evidence collected from which an accurate assessment of the revenue loss could be ascertained. However, the Committee agreed with the ANAO that revenue losses occasioned by administrative priorities within the ATO should be quantified and reported to the Government.

9.83 The Committee acknowledged the assessments conducted by the ATO to date, particularly the matching of Australian Bureau of Statistics data and ATO information and the survey of company income tax and FBT data bases. While this information may be generally indicative, the Committee considered it needed to be evaluated in the light of substantive data received from audits in this area. To this end, the Committee welcomes the ATO's proposal that FBT audits be conducted as part of on-going audits for business taxpayers.<sup>47</sup>

9.84 The Committee noted that such a program of systematic auditing would require specific training for audit staff in FBT requirements. The Committee has made recommendations concerning the training of auditors in Chapter 11.

9.85 In the overview of the Auditor-General's Report, it is stated that the increases in FBT collected between 1986-87 to 1990-91 'may be more due to inflation and the growth in total remuneration packages than to ATO effectiveness'.<sup>48</sup> This was disputed by the ATO.<sup>49</sup>

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47. Evidence, vol. 5, p. 1488.

48. The Auditor-General, op. cit., p. xiii.

49. *ibid.*, pp. xvi, 164.

9.86 In its analysis of the Audit Report the ATO maintained its position.<sup>50</sup> However from the data provided, it was clear to the Committee that inflation and salary packaging together accounted for at least 83% and 72% of gross collection growth in 1990-91 and 1991-92 respectively. As to the remaining 17% and 28%, the Committee believes some credit should have been accorded to the ATO for a proportion of this growth, although the Committee recognised that factors extraneous to the ATO could have been responsible for a percentage of this growth.

9.87 The Committee noted the ATO's criticism of the ANAO for providing findings on matters which were already known to the ATO.<sup>51</sup> The Committee strongly rejects the proposition that the Auditor-General should only report on matters unknown to the organisation under scrutiny. The Committee emphatically reminds all Commonwealth agencies and departments that the Auditor-General reports to the Parliament and should continue to report on all matters of substance, regardless of the knowledge of the issue within the audited organisation.

### **Additional Funding for Revenue Raising Activities**

9.88 In evidence to the Committee, it was revealed that for 1993-94 the Government had agreed to supplement the running costs budget of the ATO by the equivalent of \$15.8 million by waiving a debt the ATO would have been required to repay in 1993-94 under the running costs system. This money was to be used by the ATO to retain staff it would otherwise have made redundant. The ATO justified this allocation on the basis of using staff to collect taxes in respect of 'ordinary revenue raising activity'.<sup>52</sup> In the former Commissioner's words, 'In business terms, there was a revenue outcome in return for this salary money'.<sup>53</sup>

9.89 Further information provided by the ATO indicated that the staff retained by the funding allocation were expected to collect additional revenue in the following areas:

- . PAYE System - \$95 million;
- . Other Individuals - \$30 million;
- . Prescribed Payments System - \$5 million.<sup>54</sup>

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50. Evidence, vol. 18, p. S4031.

51. Evidence, vol. 18, p. S4039.

52. Evidence, vol. 4, p. 1166.

53. Evidence, vol. 4, p. 1168.

54. Evidence, vol. 15, p. S2986.

9.90 In evidence to the Committee, the former Commissioner noted:

So as to be clear, an amount of \$15m additional salary, in terms of the Budget Papers as they stand, is to be provided to us in 1993-94. This matter was the subject of discussion at Budget time, but the discussions were not concluded in time for this precise outcome to be recorded in them.<sup>55</sup>

9.91 Surprisingly, while the details of the debt-waiver-budget supplementation arrangement could not be included in the Budget papers in time for their release in August 1992, the \$130 million of revenue to be collected by the staff was apparently reflected.<sup>56</sup> At least two of the areas in which revenue was to be collected by the staff employed using the additional salary funds involved withholding taxes. The Committee concluded that the \$130 million to be collected was in fact revenue that may have been foregone had the relevant staff not been retained. Moreover, the Committee concluded that the use of the funds in this instance was not a 'commercially' prudent investment, given that on the ATO's own estimates, investments in audit functions would have produced a \$10 return for each \$1 invested.<sup>57</sup> Thus if the \$15.8 million had been used to employ audit staff, the Government could have anticipated a return to revenue of at least \$15.8 million.

## Hardship

9.92 Although the payment of tax is a legal obligation, many taxpayers do not allow adequately for or are unable to meet their tax obligations as and when they fall due. A tax debt is the equivalent of any other debt except to the extent that the Commonwealth Government has had a priority in law in collecting the tax debts of employers who have failed to pass amounts deducted from employee wages or salaries to the ATO.<sup>58</sup>

9.93 During the course of the Inquiry, the Committee became aware of a public debate concerning the merits of the Commonwealth holding a legal priority for the payment of its debts. This debate was encouraged by the high number of business failures that were resulting from prevailing difficult economic conditions.

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55. Evidence, vol. 4, p. 1165.

56. Evidence, vol.4, p. 1168.

57. Evidence, vol. 4, p. S783.

58. *Income Tax Assessment Act 1936*, s. 221P.

9.94 On 2 December 1992, the Government announced its intention to abolish the ATO's priority in debt in cases of taxpayer insolvency. The *Insolvency (Tax Priorities) Legislation Amendment Act 1993* gave effect to these changes with respect to unremitted taxation payments which fell due after 30 June 1993. The Act also allowed, amongst other things, the ATO to estimate those amounts of tax which should have been remitted by a taxpayer, when the due date for remission had passed without payment. A due debt would then be raised and recovery action could be commenced. As a result of this change, the Committee further noted the ATO's intention to strengthen its debt collection procedures in an attempt to identify and collect outstanding debts from companies prior to the company reaching the stage of liquidation.<sup>59</sup>

9.95 In the Committee's opinion the ATO has an obligation to take whatever action it deems necessary to ensure taxation revenues are collected as they fall due. Clearly there will be instances where, because of the economic position of the taxpayer, there will be an incentive for the taxpayer to defer the payment of tax for as long as possible. Such attempts present a dilemma for the ATO as enforcement of the debt may serve to propel the taxpayer into liquidation or bankruptcy. There is therefore an obvious need for the ATO to act expeditiously in a manner which is both commercially sensible and economically just.

9.96 In stating this, the Committee does not believe the ATO should be engaged in any manner whatsoever in the management of corporate entities. Rather, the ATO needs to be able to evaluate the viability of the taxpayer and the likelihood of revenue collection as a result of a number of possible courses of action. In addition, as a Commonwealth agency the ATO needs to be able to evaluate the full range of implications of imposing penalties or immediately enforcing payment from a corporate taxpayer, including the implications for the macro economy.

9.97 The Committee heard evidence which suggested that the ATO had been grossly irresponsible in enforcing a debt against a commercial taxpayer which had the effect of placing the taxpayer in liquidation and ultimately out of business.<sup>60</sup> Staff of the taxpayer had thus been made redundant and the Commonwealth had been forced to bear a direct budgetary cost in addition to indirect social costs which were not capable of estimation.

9.98 While it may be argued that this consequence was not the 'responsibility' of the ATO, from the Commonwealth's perspective the consequence of corporate failure goes beyond taxation revenue. As such the ATO has a duty to act both properly and sensitively in handling tax debts.

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59. Evidence, vol.1, p. 50.

60. Evidence, vol. 3, p. S486.

9.99 The Committee notes that the ATO already has the capacity to take action in respect of hardship claims by taxpayers. Payment by instalment, extension of the time for payment and remission of penalties are already possible as a result of the legislative power of the Commissioner.<sup>61</sup> The Committee acknowledges the ATO's determination to arrive at solutions to taxpayer circumstances which are both equitable and sensible.

9.100 Nevertheless, the Committee considers the ATO needs to develop a facility for monitoring the management of taxpayer cases in circumstances of claimed hardship. Such a mechanism needs to be developed and controlled nationally. The Committee acknowledged the difficulty in establishing a system which was perceived to be both fair and pragmatic. Taxation should not be seen as a commercial option to be bargained away in difficult times. The Committee supports the ATO's moves to enforce taxation debts at the earliest possible moment but cautions that such policies should retain a degree of flexibility and commercial reality.

9.101 The Committee recommends that:

- . the Australian Taxation Office develop facilities for monitoring the management of taxpayer hardship cases on a national basis; and
- . the Australian Taxation Office report statistics on hardship cases in the Commissioner's Annual Report.

### Relief Board

9.102 The Commonwealth's Relief Board grants relief from liability if payment of the full amount of that liability would cause serious hardship. During a period of economic hardship, claims for relief from taxation liabilities increase. This was indicated in the amount of relief granted by the Relief Board and Deputy Commissioners under delegated authority from the Commissioner in 1987-88 compared to 1992-93:

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61. *Income Tax Assessment Act 1936* s. 206; *Income Tax Ruling* 2440, 2569, 2570; Evidence, vol. 16, pp. S3276-80.

**Table 9.8 Tax and Duty Foregone 1987-88 and 1992-93**

1987-88 (\$m)	1992-93 (\$m)
1.07	11.28

Sources: Commissioner of Taxation, *Annual Report 1987-88*, AGPS, Canberra, 1988, p. 193; Commissioner of Taxation, *Draft Annual Report 1992-93*, August 1993, p. 5.

9.103 In the Taxation Commissioner's Annual Report for 1991-92, the future of the Commonwealth's Relief Board was discussed and the Committee notes the Government's intention to review the operations of the relief provisions.<sup>62</sup>

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62. Commissioner of Taxation, *Annual Report 1991-92*, AGPS, Canberra, 1992, p. 20.