Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates 2013

5 June 2013

Question: **BET 66**

Topic: **Tax gap analysis**

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Senator Cormann asked:

Senator CORMANN: As I understand it, correct me if I am wrong, the tax gap is the difference between the amount of tax payable if there was complete compliance versus the amount actually collected. Is that a fair summary?

Mr Quigley: In broad terms that is correct.

Senator CORMANN: Would you be able to provide us on notice, to the extent you can, with your most current income tax gap analysis?

Mr Quigley: Yes. What we would be able to provide you is what we have already provided, I think, to the JCPAA.

Answer:

Below is the extract from the ATO response to JCPAA report no. 434 provided 27 May 2013.

The main points in this response are:

- We continue to progress work in relation to the tax gap
- Our work includes exploring different methodologies
- The UK approach may prove to be the most appropriate for us, but is still problematic.

Information on aspects of tax gap analysis was included in our submission to the September 2012 Hearing (paragraphs 149 ff).

As suggested by that submission, a review of tax gap methodologies in use by a number of tax authorities around the world finds various approaches ranging from comparing tax collections to national accounts data through to extrapolation from random audit results.

In Australia, in relation to GST where revenue can more readily be compared to national accounts data, our efforts were flagged in paragraph 154 of our last submission and we now publish a tax gap methodology as part of our annual reporting cycle, starting in the 2011-12 Commissioner's annual report. In addition, we have published a tax gap for luxury car tax and are exploring options to estimate tax gaps for other indirect taxes such as excise duties. (see also recommendation 6)

In relation to income tax, we are doing exploratory work on potential tax gap measures for aspects of income tax.

To develop income tax gap measures using high level data, such as the national accounts, requires a detailed understanding of the underlying data and may involve complex manipulation of the published data to ensure its comparability with the taxation data.

Random audits can provide a reasonably accurate base from which to extrapolate, assuming the random audit sample is big enough. They may, with a big enough sample, illustrate the fact that a tax gap can be driven by a range of behaviours, from outright evasion to, for instance, inability to pay debts.

The difficulty is, as discussed at earlier hearings, that the number of random audits required is large (at least several thousand) and would significantly divert resources from existing audit programs, which deliberately target high risk taxpayers. Random audits would also be intrusive for low-risk taxpayers. Finally, the validity of the results from random audits is highly dependent upon achieving a high degree of consistency in the audits, which in practice may be difficult to achieve.

One option may therefore be a mix of methodologies. The UK, for instance, has not found it possible to develop a "top down" approach for direct taxes, but relies on a mix of methods and data, including audit results and expert analysis of the effect of known risks to revenue.

Even then, the UK measurement, while indicative, is not regarded as completely comprehensive.

We continue to monitor, as noted in paragraph 153 of our earlier submission, methodological developments in relation to the tax gap.

Other tax gap methodologies examined include taxpayer surveys. However, there is a concern that surveys for tax gap purposes are expensive and again, may be intrusive. There is a further concern that survey results may not always be reliable, given potentially low response rates and a possible tendency by respondents to understate any non-payment.

Some commentators, less convincingly, have suggested comparisons with changes in the amount of cash circulating in the community (on the basis that the cash economy is a major driver of a tax gap) and measures of changes in the rate of use of electricity (since electricity use is sometimes regarded as a proxy for economic activity).

Of course, neither of these measures is comprehensive or sufficiently reliable. In reality, it would be unlikely that a cash economy would be the only contributor to a tax gap, and a measure of electricity use is probably not appropriate in today's digital economy.

In the meantime, the ATO has focussed primarily on measuring "compliance effectiveness". The "compliance effectiveness" work is around a series of measures which align with the OECD "Four Pillars of compliance" namely registration, correct lodgement, correct reporting, and payment on time). It was first reported by our then Commissioner of Taxation to the Committee for Economic Development of Australia in February 2011 and has been further reported through the *Compliance Program 2012-13 - Appendix 07 Evaluating our performance 2011-12*.

For individuals, for example, compliance effectiveness measures are:

- the numbers of individual TFN registrations compared to the numbers in the population (adjusted for non-residents);
- salary and wages reporting in income tax returns compared to Australian Bureau of Statistics data about salary and wages;
- numbers of returns lodged on time compared to numbers lodged in total; and
- numbers of taxpayers paying on time compared to numbers paying by 30 June of the financial year in which they are due.

We have equivalent measures for other market segments. In particular, in the 2012 annual report, there was information on the trend in company profits compared to income tax payable (showing that over time they were moving roughly together).

This compared profits and net income tax from company tax returns with adjusted "gross operating surplus" for companies. "Gross operating surplus", calculated by the Australian Bureau of Statistics, is a measure of economy-wide profit in the corporate sector. It is adjusted for this purpose, to exclude the elements which relate to exempt companies and add back interest received and inventory valuation adjustments.

We are updating with a view to publishing the results of our compliance effectiveness measures in the first quarter of the new financial year. In some ways, these are of more benefit than a macro-level measure because they give at least some detail about where problems are arising.

We would expect to be able to report by the end of this calendar year, including to the Committee if it wishes, on further consideration of tax gap issues.