



Australian Government
Inspector-General of Taxation

NEW IGT WORK PROGRAM ANNOUNCED

The Inspector-General of Taxation has consulted widely with business, taxpayers, tax practitioners (legal and accounting), professional bodies and industry associations about areas of tax administration that could be improved. The Assistant Treasurer, the Hon Chris Bowen MP, Joint Committee on Public Accounts and Audit (JCPAA), the Commonwealth Auditor-General, the Commonwealth Ombudsman, the ATO and the Treasury have also been consulted. Overall, the consultation process considered over 50 written and oral submissions from the community, which collectively raised over 160 issues.

This process surfaced a wide range of issues and concerns about tax administration that the community considered should be reviewed by the Inspector-General. Some of these issues and concerns have also been raised with the Assistant Treasurer and the ATO.

At the direction of the Assistant Treasurer and in response to submissions from concerned taxpayers, the Inspector-General will undertake a review into **the implications of any delayed or changed ATO advice on significant issues**. Taxpayers and tax professionals have cited examples of where they considered that the ATO's views had undergone "U-turns" on significant interpretative matters or on past practices, especially where they had retrospective application. ATO opinions that came after lengthy periods of having no ATO view, at times inconsistent with policy intent but with retrospective application were also raised as concerns.

In response to an invitation from the Commissioner, the Inspector-General will also undertake a **review of the private rulings system**. One of the most repeated concerns raised in submissions to the Inspector-General was the ATO's proposal to withdraw the public register of private rulings. Having conducted its own consultation process including discussions with the Inspector-General, the ATO has decided to retain the register, and has suggested that the Inspector-General undertake a broad review of the private rulings system. The issues that this review will consider include productivity, timeliness and the system's future integrity. The use of the register of edited private rulings will also be examined together with related authoritative (but non-binding) forms of ATO advice such as ATO Interpretative Decisions (ATOIDs).

From the wide range of other issues raised in consultation, the Inspector-General has distilled the following further issues that will form his work program for 2009 and into 2010 (subject to any matters of overriding priority that may arise):

- **Review into the ATO's administration of the Superannuation Guarantee Charge (SGC).** Submissions questioned the adequacy of the ATO's efforts to improve employer compliance with their SGC obligations, the consequences for employees and the ATO's timeliness in collecting unpaid SGC.
- **Review into the ATO's practices for finalising large company audits.** Stakeholders applauded the ATO's commitment to finalising large company audits within two years. However, a number of concerns were raised particularly in relation to initial delays resulting in truncated processes being adopted towards the end of the two years in order to achieve the targeted timeframe.

- **Review into the ATO's compliance focus on Small to Medium Enterprises (SME).** Taxpayers and their advisers cited unmanageable and at times unnecessary costs and workloads caused by the ATO's approach to its current compliance focus on all SMEs in the \$100 million to \$250 million turnover range.
- **Review into the efficiency of the ATO's compliance and regulatory approaches to Self Managed Super Funds (SMSFs).** Discussions with industry representatives indicated that the ATO has made good progress in relation to SMSFs and that relationships are generally good. However, a number of submissions and tax professionals cited the heavy compliance workloads and processes, and opportunities for improved efficiency.
- **Follow-up review into the ATO's implementation of agreed IGT recommendations.** This second follow-up review will focus mainly on the ATO's progress with implementing changes agreed in the IGT's 6 reviews released between April 2007 and October 2008.

More detail on the background and focus of these proposed reviews is in the attachment.

Specific terms of reference for each review will be issued after detailed work is carried out to refine their scope and focus. Concerns raised in relation to the above topics will be factored into the terms of reference for each review. It is expected that public submissions will be sought on each review in addition to those already received.

Other strong candidates for review topics came forward from the consultation process and some were shortlisted for review but have not made the list at this time. In several cases this is because they are being considered elsewhere, including through the Henry review or through direct stakeholder work with the ATO. The Inspector-General will monitor progress with these potential review topics and may elevate them into his active work program as priorities and resources allow. These topics include:

- Issues of concern with the ATO's outsourcing of aspects of collecting tax debts.
- The ATO's administration of income tax refunds.
- The appropriateness of the ATO's dual role of regulator and tax administrator for charities.
- ATO governance and appropriate level of independent oversight.
- The role and capacity of the ATO's Tax Counsel Network (TCN).
- The ATO's use of its formal information gathering powers.
- Opportunities for efficiencies and cost savings through more flexible use of the Commissioner's substituted accounting period (SAP) discretion.
- The extent to which the ATO's Change Program will deliver improvements to taxpayer services including taxpayer accounts, assessment notices and objections handling.
- The potential for proactive use of the Commissioner's general powers of administration to make it easier for taxpayers to meet their obligations.
- The reasons why a substantial proportion of penalties raised by the ATO is conceded at objection, settlement or litigation.

The Inspector-General thanks all those in the community that provided input over recent months to the development of his work program.

FOCUS OF PROPOSED REVIEWS

REVIEW INTO THE IMPLICATIONS OF DELAYED OR CHANGED ATO ADVICE ON SIGNIFICANT ISSUES.

Concerns have been raised with the Assistant Treasurer and the Inspector-General in relation to the adverse impacts of perceived ATO's changes of practice - so called "U-turns" - or delivering its advice after long periods of uncertainty.

In submissions, groups representing large businesses, small-medium sized businesses and the legal profession raised examples that underpinned their perceptions including the ATO's approach to service trusts, managed investment schemes, transfer pricing and thin capitalisation rules, royalty withholdings on copyright payments, trust cloning and the taxation of trusts more generally.

The self-assessment system imposes significant responsibility on taxpayers to correctly interpret and apply the tax laws. The ATO, as tax administrator, regards itself as a professional advisor to help taxpayers correctly comply with those laws by providing reliable and timely advice on the tax laws.

The ATO often may not provide advice in areas of known uncertainty, including new tax laws, for some time. The timeframes may be protracted due to lengthy periods of ATO consultation with taxpayers and their representatives. Nevertheless, this leaves taxpayers to determine their own view in order to meet their obligations. In other cases, there may be an actual change or strong perceptions that the ATO has changed its previously stated view of the law.

When the ATO does convey its view, it often does so by stating that it is not changing any pre-existing opinion, but that its view is merely an expansion on what the law has always said. This may effectively mean that its view is to be applied retrospectively. This approach may be unfair where taxpayers have insufficient time to avoid adverse consequences by changing arrangements they have had in place for some time and of which they believe the ATO was well aware.

The examples purportedly represent what stakeholders have termed "a lack of prospective certainty" involving:

- an actual change in ATO view;
- tacit ATO acceptance that a range of arguable views are available on these issues before it announces its final view;
- tacit ATO acceptance or awareness of how taxpayers are or may be applying the law, but taking no action to warn taxpayers for long periods of time until the "new" ATO view is announced; and/or
- subsequent ATO action (such as a new ATO view) which retrospectively applies its view in these circumstances or where it is inconsistent to the previously accepted position or policy intent as deduced from legitimate extrinsic materials.

The ATO's position on whether it has changed its view or not can determine whether taxpayers have the certainty of knowing that the ATO will apply its view only on a prospective basis, and therefore what protection they have from additional tax, interest and shortfall penalties.

The Assistant Treasurer has directed me to conduct a review in relation to the above concerns and, in particular, determine:

- whether perceptions are justified that the ATO changed its views with retrospective application in the examples provided;
- how the ATO provides “prospective certainty” (to the extent it can);
- whether the time taken by the ATO to announce its views and the way it has applied them have caused adverse consequences for taxpayers;
- what options taxpayers could or should have in these circumstances and whether any alternative processes would deliver improvements.

REVIEW OF THE PRIVATE RULINGS SYSTEM.

Australia is amongst one of the few countries in the world to have a system where the revenue authority is able to issue legally binding written advices (called private rulings) to particular taxpayers on how the ATO considers that the income tax law applies to a particular arrangement. Subject to certain conditions, these rulings are legally binding on the ATO. This means that if a taxpayer follows the advice in a private ruling that has been issued to them, the ATO cannot levy additional income tax, penalties and interest if that advice is wrong.

In 2004, Treasury’s *Review of Aspects of Income Tax Self Assessment* (the RoSA review) found that there was a need to improve the ATO’s system for providing private rulings by making such types of advice more timely, accessible and binding in a wider range of cases.

Tax laws underpinning the private rulings system were subsequently amended to give effect to 8 of 14 RoSA recommendations. The remaining 6 were to be addressed by the ATO through administrative processes. The ATO has stated that it has implemented, or set in place processes to implement 5 of these 6 recommendations.

The RoSA review also made an administrative recommendation that the Inspector-General would be requested to conduct a review of whether the pattern of private rulings indicated a pro-revenue bias. The Inspector-General completed this review in early 2008 and made 10 recommendations, 6 of which the ATO fully agreed to implement.

Taxpayers and tax practitioners have stated in submissions that there continue to be problems with the ATO’s administration of private rulings including:

- the future transparency and integrity of private rulings processes in view of the ATO’s proposal to cease publishing the register of edited content of private binding rulings (however, the Inspector-General notes that, following consultation, the ATO has announced that it has decided to retain the register);
- the extent to which the contents of private ruling advices are binding particularly where there is an issue of whether the anti-avoidance provisions (Part IVA) could apply; and
- private binding rulings taking too long to issue and that ATO statistics on completion times are misleading.

Finally, private rulings have for many years been managed by the ATO using its Technical Decision-Making System (TDMS) which incorporates a number of important controls aimed at maintaining integrity, consistency and quality in private rulings. The ATO has advised that it intends shortly to move its management of private rulings to a new computer system as part of its multi-million dollar Change Program aimed at making taxation easier, simpler and cheaper for taxpayers.

The ATO has suggested that there would be benefit in the Inspector-General undertaking a broad review of the private rulings system, including issues of productivity, timeliness and the system’s

future integrity. The use of the register of edited private rulings will also be examined together with related authoritative (but non-binding) forms of ATO advice such as ATO Interpretative Decisions (ATOIDs).

This review will therefore:

- examine the use of the register of edited private binding rulings together with related forms of ATO advice such as ATOIDs;
- investigate timeliness and productivity concerns, and the extent to which ATO has made private rulings more accessible and binding in a wider range of cases;
- examine the extent to which the ATO has implemented the administrative recommendations on private rulings made in Treasury's 2004 RoSA review and the Inspector-General's 2008 review on the potential revenue bias in private rulings; and
- examine the extent to which the proposed move to a new information technology base will maintain the integrity and quality of private rulings and deliver benefits to taxpayers.

REVIEW INTO THE ATO'S ADMINISTRATION OF THE SUPERANNUATION GUARANTEE CHARGE (SGC).

The superannuation guarantee system began on 1 July 1992 and represents an important pillar of Australia's retirement income system. It requires all employers to provide a minimum level of superannuation each year for each employee, currently set at 9 per cent of an employee's remuneration. Where an employer fails to provide the minimum level of support, the employer is liable to pay a non-deductible charge called the Superannuation Guarantee Charge (SGC).

The Commissioner of Taxation is charged with the general administration of the SGC scheme and collects the charge where employers do not provide a minimum level of superannuation support for their employees. Between 2002 and 2006 successive governments provided additional support to the ATO, including specific additional funding, to improve its enforcement and compliance monitoring of whether employers are providing the required level of superannuation support.

The ATO agreed to improve employer compliance through enhanced data matching to determine SGC shortfalls, client communication, and the issuing of default assessments to employers. This included the provision of improved services to employees with concerns about payments of employer superannuation contributions. Backlogs of inquiries and more timely completion of future investigations were also to be addressed.

The ATO was also to provide employees with more advice on the progress of SG inquiries. The then Assistant Treasurer said that improving the timeliness and quality of ATO investigations into superannuation payments made by an employee's past or present employer would significantly reduce the level of frustration that employees may have with the administration of the Superannuation Guarantee system.

Stakeholders raised concerns with the general level of compliance in this area and, in particular, the ATO's timeliness and responsiveness to employee complaints regarding the non-payment of superannuation guarantee. Concerns were also expressed about the adequacy of the ATO's enforcement action and monitoring and the level of outstanding SGC collected: *"...the ATO don't chase up short payments of SGC. There's so little follow-up on the ground...its all done by press release to leverage compliance."*

Changes to the superannuation legislation were introduced to increase information disclosure to address a common cause of employee complaint. The Ombudsman has kept a watching brief on the implementation of the new legislation and finalised an informal review in early 2008-09. The Inspector-General intends to work together with the Ombudsman's office in the course of this review to identify appropriate opportunities for improvement in the ATO's compliance approaches and handling of employee complaints.

This review will examine the ATO's administration of the Superannuation Guarantee Charge to form a view as to whether it has done as much as it reasonably could have to improve employer compliance. It aims to identify the level of non-compliance, assess how the ATO was dealing with the problem and if necessary provide recommendations for improvement. The review will also consider the ATO's:

- risk assessment strategies for SGC and its implementation of strategies to improve compliance (such as education, employer assistance, audit and enforcement).
- communication strategies with employees raising concerns with their employer's compliance, the timeliness of actioning employee notifications and the level of information provided about the collection of unpaid superannuation.
- timeliness in collecting unpaid superannuation guarantee.

REVIEW INTO THE ATO'S PRACTICES FOR FINALISING LARGE COMPANY AUDITS.

The ATO's audit practices and approaches have a significant impact on business, not only in terms of the cost of compliance but also the potential for further, and unnecessary, disputation. Many, including the Inspector-General, welcomed the ATO's aspiration to resolve large company audits within two years. However, the Inspector-General received repeated concerns from taxpayers that this target was driving inappropriate ATO behaviours and increasing the level of disputation.

Tax advisers submitted that in many cases the timeframe has not achieved more efficiency and effectiveness in the handling of audits. They said that audits are being finalised within the two years, but the way they are being handled is not achieving the aim of trying to resolve disputes as early as possible. They submitted that delays in the early stages of audits were resulting in important processes being truncated towards the end of the two years in order to achieve the targeted timeframe. Important processes being compromised include providing taxpayers with reasonable opportunities to respond to ATO position papers, serious consideration by the ATO of taxpayer responses, and the extent of dialogue between taxpayers and the ATO in establishing agreed facts.

This review will examine to what extent taxpayer concerns are justified. It will examine the management of selected large company audit cases with a focus on important milestone events and the underlying issues and behaviours. It will consider if ATO behaviours are leading to extended timeframes or further disputes. This will provide a basis for conclusions to be drawn and recommendations of best practice in the handling of audits in the large market segment.

REVIEW INTO THE ATO'S COMPLIANCE FOCUS ON SMALL TO MEDIUM ENTERPRISES (SME).

Taxpayers and their advisers have expressed concerns regarding the costs and inefficiency of the ATO's current compliance approaches to the high end (turnover \$100 million to \$250 million) of the SME sector. In relation to reviews and audits, these include the ATO using 'generalist' audit

teams who are unfamiliar with both the industry and the operation of key areas of the tax law, and the taxpayer's lack of access to technical specialists within the ATO.

Some taxpayers have also suggested that the ATO is conducting audits in order to train up their audit teams in a particular area of the law; some taxpayers claim they were picked for review or audit just because the ATO knew their business from a previous audit.

Tax professionals noted that the ATO's current risk review of all SMEs with a turnover between \$100 million and \$250 million and of all company losses has led to significant and expensive workloads that neither the taxpayer nor the ATO can actually manage. In particular, the review of losses going back twenty years in some instances has placed a significant burden on taxpayers, with the need to keep and provide records for so long proving time consuming, costly and cumbersome.

This review will identify the reasons for the ATO's wide-ranging approach to the top end SME sector and the scope of its activities. It will form views about whether the ATO's risk-management analysis justifies its focus on the sector and if its approaches are reasonable, efficient, and cost effective. The review will explore whether this compliance activity is causing any unreasonable impacts and costs for affected SMEs and their advisers and will aim to identify potential improvements.

REVIEW INTO THE EFFICIENCY OF THE ATO'S COMPLIANCE AND REGULATORY APPROACHES TO SELF MANAGED SUPER FUNDS (SMSFs).

There are over 390,000 SMSFs in Australia with over \$358 billion of assets. In recent years there has been a rapid growth in SMSFs, both in terms of numbers and the value of assets under management.

The ATO, unlike other spheres of taxation, performs several different and distinct roles in relation to superannuation entities, including:

- the administration of taxation law as it applies to superannuation entities; and
- the prudential regulation of SMSFs to ensure their compliance with the superannuation law.

In 2007 additional government funding was provided to increase the ATO's focus on SMSFs with an expansion of its compliance activities. The ATO has adopted a 'prevention is better than cure' approach to help trustees understand their responsibilities and comply with the tax and superannuation laws.¹ This approach has included developing a self managed fund start-up kit provided to all new trustees, upgrading the content on its website and undertaking a program of special compliance checks to assist trustees step up to their new role and responsibilities. This includes obtaining written confirmation certifying that a trustee properly understands their obligations, as is now required by law.

However, SMSF trustees believe that the combination of the current regulatory environment and ATO reporting requirements is imposing a significant and excessive cost of compliance on SMSFs. Practitioners and SMSF trustees have also expressed concerns with the compliance burden around reporting and lodgement, while advisers believe that the ATO should provide more information to the market regarding the performance and costs of compliance in the SMSF sector.

¹ Michael D'Ascenzo, A common goal: securing retirement incomes for Australians, Speech to the Self-Managed Super Fund Professionals' Association of Australia (SPAA) National Conference Brisbane Convention and Exhibition Centre, South Brisbane, 12 March 2008

This review would examine the efficiency around reporting, lodgement and cost of compliance generally, and consider if the ATO “auditing the auditors” program is efficient and effective. It will also consider whether there is an appropriate balance between the administrative obligations imposed on SMSF trustees to ensure that they comply and the risk of non-compliance with the *Superannuation Industry (Supervision) Act 1993*.

FOLLOW-UP REVIEW INTO THE ATO’S IMPLEMENTATION OF AGREED IGT RECOMMENDATIONS.

In March 2008, the then Inspector-General completed a review to follow-up on the extent to which the ATO had implemented agreed recommendations arising from his reviews released between 2003 and 2006. The Inspector-General will include in his work program for 2009-2010 a second follow-up review to focus on implementation of agreed recommendations from the following six reviews released between June 2006 and October 2008:

- Review of Tax Office Management of Complex Issues - Case Study on Service Entity Arrangements - *publicly released 24 April 2007*.
- Review of Tax Office Management of Complex Issues - Case Study on Living Away From Home Allowances - *publicly released 10 May 2007*.
- Review of Tax Office Management of Complex Issues - Case Study on Research and Development Syndicates - *publicly released 16 August 2007*.
- Review of the Potential Revenue Bias in Private Binding Rulings Involving Large Complex Matters - *publicly released 25 February 2008*. (Follow-up of agreed recommendations for this review will be undertaken as part of the Review of the PBR system described above.)
- Review of the Tax Office's administration of GST audits for large taxpayers - *publicly released 11 June 2008*.
- Report on improvements to tax administration arising from the Inspector-General's case study reviews of the Tax Office's management of major, complex issues - *publicly released 29 October 2008*.

This review may also examine any outstanding issues from reviews completed prior to those listed above.