Australian Taxation Office

Compliance Program
2002–03

Australian Taxation Office

‘Through our compliance program, we seek to optimise collections and make payments under the law in a way that instils community confidence that the system is operating effectively.’

MICHAEL CARMODY
COMMISSIONER OF TAXATION

ENVIRONMENT, CHALLENGES, RISKS, CHARTER AND COMPLIANCE

The environment

Australia's revenue systems operate in an increasingly complex environment. This includes growth in international trade (supported by e-commerce developments), changes in employment patterns and growth in numbers of contractors, innovations in business structures and financial products, and the commoditisation of tax schemes. A number of factors have substantially increased revenue risks and the complexity of compliance interactions.

With globalisation comes the increasing need for tax administrations around the world to cooperate to help each country administer its revenue system. This issue affects global corporations, the highly mobile executive market, and small businesses through to backpackers. Our work with the Organisation for Economic Cooperation and Development (OECD) and other international organisations aims to find ways to ensure the correct tax is paid in the correct jurisdiction.

The volume of compliance interactions has also increased as part of the design of the new tax system. Business people and their representatives, including tax agents, are looking to improved administrative approaches to ease the cost of compliance.

Ageing of the population and an increased emphasis on providing for retirement have resulted in initiatives such as the Senior Australians Tax Offset, the continuing personal superannuation contributions to age 75 initiative, and an increase in the use of self-managed superannuation funds.

The ageing of the population is mirrored in the profile of the Australian Public Service, raising new workforce planning issues for the Tax Office.

Challenges

Our challenges are to continue reform implementation and deliver the revenue and compliance improvements promised by the new revenue systems, while making the experience easier, cheaper and more personalised.

Risk management

The fundamentals of revenue administration in Australia are embedded in our system of self-assessment.

The adoption of the self-assessment system reflects the reality that a system based on reviewing every transaction or event that may have a tax consequence would be too intrusive, time-consuming and costly for everyone involved. The Tax Office is not, and can never be expected to be, resourced to review every transaction or event.

Equally, the adoption of the self-assessment system reflects the reality that effective revenue administration is not about collecting every last dollar payable under our revenue laws.

Accordingly, revenue administration is founded on managing risk, leveraging the impact of interventions, and responding quickly to changing circumstances.

But it is more than that because community confidence in our administration of the system is equally affected by perceptions and judgments of fairness. Our approaches are thus guided by the *Taxpayers' Charter* and the Compliance Model.

The *Taxpayers' Charter*

The federal tax system operates for the benefit of the community, and both the Tax Office and taxpayers have an important role to play.

The charter is about openness and treating people fairly and professionally within the context of the law. This includes commitments to inform people of their rights, obligations and entitlements under the law.

The charter also details services that taxpayers can expect from the Tax Office.

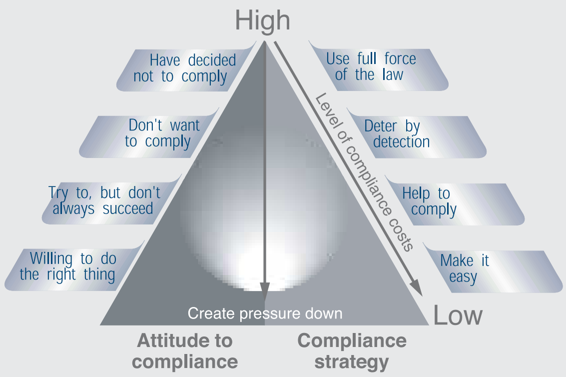
The Compliance Model

The Compliance Model is a structured way of helping us to understand the factors that influence different compliance behaviour. This enables us to choose the most appropriate intervention for the circumstances.

Taxation compliance behaviour is influenced by many factors – business, industry, sociological, economic and psychological – all of which influence whether a person chooses to meet their obligations. The model shows a continuum of taxpayer attitudes towards compliance. At the base of the continuum, taxpayers have the desired attitude of being 'willing to do the right thing'. At the other extreme, taxpayers have decided not to comply – choosing to evade or opt out of the tax system.

The model also summarises the different sorts of support and intervention that we may need to provide to collect the required revenue. The model suggests that the Tax Office has the ability to influence taxpayer behaviour through our response and interaction.

Factors that influence taxpayer behaviour



INTRODUCTION

This publication looks at key components of the tax system, including the trends, major compliance risks, and remedies across various elements of the community.

The cover offers some context around the tax environment. We then move to:

- information on the individuals segment (page 2).

It is important for the Tax Office to view the community through different lenses so that we continue to appreciate a range of perspectives and develop approaches that meet community needs. For example, the business community is made up of organisations with vastly differing circumstances and characteristics. To break this down, in some circumstances we view the business community on an industry basis, at other times by different attributes. In this publication, we break up the business community by turnover:

- micro-business segment (page 4) – annual turnover of less than $2 million
- small to medium enterprises segment (page 6) – annual turnover of between $2 million and $100 million, and
- large business segment (page 8) – annual turnover of over $100 million.

The non-profit and government segment has some particular attributes, while having less revenue impact than other segments, so we profile:

- the non-profit and government segment (page 11).

Next, we look at:

- registered tax agents and their indispensable contribution to helping us manage the community's tax system (page 12).

While some risks and remedies are unique to a segment, there are others that go across two or more segments. This section focuses on some of the high-profile cross-segment risks:

- international (page 14)
- aggressive tax planning (page 16)
- debt and lodgment (page 18)
- the cash economy (page 20), and
- evasion and fraud (page 21).

We draw together other topic areas:

- goods and services tax (page 22)
- excise (page 25), and
- superannuation (page 26).

We finish by explaining how the Tax Office is resourced to manage the tax system:

- the ATO Plan 2002–03 shows how we allocate resources (page 28), and
- the link between our plans and governance arrangements illustrates our overall management system (page 29).

We welcome your feedback on this program, please see the back cover for contact information.

Under development

The tax system has undergone unprecedented change in recent years, with a particular impact on the business community and tax professionals. Inevitably, some changes have been smoother than others.

The Tax Office is working closely with the community to solve problem areas, and to make people's experience of the tax system easier, cheaper and more personalised. Some changes have already been made, while others involve pilots or prototypes before they can be introduced. Look for the 'Under development' feature to gain an overview of what we're doing to help.

Around 10 million individuals, predominantly salary and wage earners, make up the largest group in the tax system. Revenue from individuals in 2001–02 was $62 billion, or 37% of Commonwealth revenue.

More than ever, individuals are earning income from investments in shares and other sources. There is also a growing range of deductions and offsets being claimed through the tax system.

The nature of many policy initiatives – such as the Baby Bonus, the Senior Australians Tax Offset and the Family Tax Benefit – means there is an increasing need to customise our mix of help and compliance strategies.

Approximately 25% of individuals prepare their own returns, the remainder use tax agents.

OUR GENERAL APPROACH

Because of the size and nature of this segment, the primary focus of our activities is how to best help and educate people about their obligations and entitlements.

We tailor products and services for families, youth, senior Australians, investors and employees. Examples include *TaxPack*, *e-tax* (the online equivalent of *TaxPack*) and other electronic information, the Tax Time media campaign, and a wide range of publications. We train 2,000 community volunteers to help low-income earners and the elderly prepare their tax returns.

We also respond to 4.2 million phone enquiries, 20,000 emails and 1.2 million visits to tax offices.

Our compliance effort is largely directed at:

- working with tax agents, because they help 75% of individual taxpayers complete their tax returns
- matching information from financial institutions and other sources to confirm that income has been included and to identify growing risks
- analysing information provided on tax returns and other reports to identify cases that we may need to check, and
- reviewing claim information against benchmarks in a cross-section of occupations and industries.

We also respond to 4.2 million phone enquiries, 20,000 emails and 1.2 million visits to tax offices.

Given that 85% of taxpayers in this segment receive refunds, there are relatively few problems with debt or taxpayers not lodging returns. Most of the 300,000 debt cases each year are handled by coming to satisfactory payment arrangements with the individual taxpayers.

OUR COMPLIANCE FOCUS

Low levels of understanding of new obligations and entitlements

Because there is an increasing number of benefits claimed through the tax system, we monitor initiatives to ensure that benefits are paid to those entitled to receive them. Last year we identified 66,000 seniors who were entitled to, but did not claim, the Senior Australians Tax Offset. They were paid approximately $63 million through action we initiated. We are also ensuring that those entitled can claim benefits for the Baby Bonus and newly allowed deductions for sun protection products.

Overclaiming work expenses

Work expenses, such as car, travel, uniform, laundry and self-education, amount to 57% of total claims by individuals. Some 6.7 million taxpayers claimed $8.8 billion in 2001, an increase of nearly 11% on 2000. While some of this is related to goods and services tax (GST), we are working with tax agents and industry representatives to better understand this increase. We have also selected 135,000 taxpayers from different occupations and asked them to confirm these deductions.

Overclaiming rental expenses

In 2001, 1.3 million taxpayers declared rental income of $12.6 billion and claimed rental deductions of $13.3 billion. While rental income is up 7% on the previous year, deductions claimed have increased by 15%. We have selected 10,000 taxpayers to provide more details about their claims.

Overclaiming interest and dividend deductions or not including interest and dividends

Over 100 million transactions from banks, financial institutions, Centrelink, and private health insurance companies are matched to information lodged in around 12 million tax returns. This year, some 230,000 discrepancies worth $120 million will be followed up with taxpayers.

The Tax Office also shares information with Centrelink, which last year recouped over $300 million in overpaid benefits.

Profiling reveals excessively large refunds and interest and dividend deductions. We will review around 6,600 of these claims and about 5,800 high-risk refunds in seeking to identify fraud and aggressive tax planning (see aggressive tax planning, page 16).

Not reporting income from capital gains on sale of shares and properties

About 1.4 million taxpayers earn about $6 billion in net capital gains. This year we will compare 1,100 tax returns with share trading and rental property sales data.

Working holiday-makers and backpackers claiming resident status to receive the tax-free benefit threshold

In 2002 we adjusted over 9,000 tax returns and contacted selected tax agents, raising some $17 million in revenue.

Avoiding tax through schemes

We are watchful of emerging schemes and warn the community of the tax implications through a system of taxpayer alerts, taxation rulings and other advice (see aggressive tax planning, page 16).

Around 2.5 million small businesses have an annual turnover of less than $2 million. These micro-businesses account for around $19 billion, or just over 10%, of Commonwealth revenue, and around 60% of the collectable debt managed by the Tax Office.

Micro-businesses account for a large proportion of the 400,000 businesses eligible for excise rebates (see excise, page 25) and many of the 240,000 self-managed superannuation funds (see superannuation, page 26).

Over 80% of micro-businesses have an annual turnover of less than $200,000. Most are family businesses with few or no employees, and a significant number operate from home. There is a very high turnover of these businesses and their owners.

While around 95% rely on tax agents to prepare their income tax returns, only 55% use a tax agent to prepare their activity statements.

OUR GENERAL APPROACH

Our primary focus is to help and educate this segment about their obligations through their tax agents and industry associations, and by providing them with information directly.

A particular focus is on providing education products for new and intending business owners to help them start out on a sound basis.

The Tax Office's business tax infoline will handle around 6.8 million phone calls this year, and there is a wide range of information and help services available from our website. Business operators can also visit ATO*access* centres to speak directly to our enquiry staff, or request a visit from a field officer.

We also offer our information services through an extensive business education network. This comprises educational institutions, local government and other intermediaries such as business enterprise centres, New Business Enterprise Incentive Scheme providers, small business assistance officers, business information centres, Indigenous communities, and regional and remote service centres.

In addition to these help services, around 3,000 field staff conduct an extensive audit program in the small business area. Around one in ten micro-businesses can expect to be contacted as part of the program this year, with a particular focus on GST and income tax matters.

This program will also check employer obligations such as pay as you go withholding, fringe benefits tax and superannuation contributions.

We analyse information provided on activity statements, tax returns and other information reports to identify cases that we may need to check.

We contact businesses by letter or phone, or arrange face-to-face visits. Small business operators can always have their tax agent represent them as part of these activities.

We have an extensive program to remind small businesses to lodge their activity statements and tax returns, pay on time and meet their other obligations. Businesses having difficulty in meeting these obligations can seek extra time, with requests considered on a case-by-case basis (see debt and lodgment, page 18).

The government provided the Tax Office with additional funding this year to improve the level of information and help services, and increase our audit capability in this segment.

OUR COMPLIANCE FOCUS

Inadequate record keeping and cash management

For many micro-business owners, business record keeping is driven largely by their tax obligations. They understand their businesses but often have little time for record keeping and limited accounting knowledge. These factors combine to create a high risk that business records will be inadequate for tax and cash flow management purposes.

To address these risks, the Tax Office provides a range of products and services to support new and existing businesses with record keeping and other tax-related issues. These include *E-Record*, a free electronic record keeping tool designed to help business owners complete their activity statement and simplified tax system obligations. We also have a registered software facility to help business owners find an accounting software package that meets their needs, and a range of printed and electronic information products.

This year we expect to make up to 50,000 advisory visits in response to requests from micro-business owners seeking help with basic tax knowledge and record keeping systems.

This year we expect to make up to 50,000 advisory visits in response to requests from micro-business owners seeking help with basic tax knowledge and record keeping systems. We will undertake around 8,000 record keeping reviews to check record keeping practices.

With a high proportion of the debt managed by the Tax Office relating to micro-businesses, it is important that we contact these businesses early to ensure unexpected tax debts do not threaten their ongoing viability (see debt and lodgment, page 18).

Low levels of understanding

Micro-business operators are often more skilled at their core business activities than at managing their tax affairs. Many mistakes they make are due to a lack of knowledge rather than deliberate attempts to avoid their obligations.

A common error made by micro-business owners is to incorrectly assume they are entitled to an Australian business number (ABN) and can register for GST. This can result in people completing activity statements and claiming GST refunds to which they are not entitled.

People may also assume they are carrying on a business and incorrectly register for an ABN and GST. This may occur where an individual is engaged as a contractor but, due to the nature of their work arrangements, is a common law employee. The use of contractors is an increasing trend and we will be checking to ensure the law is correctly applied.

A related issue concerns taxpayers who earn their income from providing their personal services. The Tax Office will be checking that these taxpayers understand the new alienation of personal services income rules that limit income splitting and some business deductions.

In other situations, the activities undertaken are not currently profitable and may never become a viable business. The Tax Office will continue to check whether these kinds of activities amount to carrying on a business and, if so, whether the non-commercial loss rules apply to restrict their ability to claim losses against other income.

Other common errors include claiming input tax credits for the full amount of a purchase where the goods or services are used partially for private purposes, or failing to exclude private expenses when claiming input tax credits and deductions for expenses. Failing to correctly classify sales and purchases of capital items also leads to errors in calculating GST and capital gains tax (see GST, page 22).

Non-disclosure of income

Smaller businesses often deal in cash and generally operate in a very competitive market. This increases the likelihood of some of them failing to disclose part or all of their income. Many of them can expect to be contacted by the Tax Office this year (see the cash economy, page 20).

In particular, the Tax Office will be following up cases where the information provided on activity statements and tax returns does not appear consistent with previous periods or with other similar businesses.

Businesses will be contacted where they have registered for an ABN, but not previously lodged tax returns.

Under development

Initiatives we're working on with businesses of all sizes include:

- providing more electronic options for registration, reporting, payment and access to personalised information and advice
- redesigning information products:
  - from the user's perspective
  - developing different products for people's different information needs
- improving our letters:
  - reducing the volume of letters
  - writing letters from the user's perspective
- providing improved phone services with new features:
  - making our services faster and more reliable for clients
- improving record keeping requirements:
  - providing clear, consistent rules
  - seeking community support to standardise records/source documents
  - encouraging electronic operations

There are around 100,000 businesses with an annual turnover between $2 million and $100 million. These small to medium enterprises account for around $16 billion, or 8.5%, of Commonwealth revenue.

These businesses employ around 1.8 million Australians, with much of the recent growth in the economy taking place in this segment. International business dealings are increasing rapidly in this area of the economy. The top industries are construction, manufacturing, property and business services, and retail and wholesale trades.

Smaller enterprises share many of the characteristics of micro-businesses. They are typically owner-operated and around 85% have an annual turnover of less than $10 million. Nevertheless, medium-sized enterprise business arrangements can be as complex as those of large public companies.

This segment represents 19% of collectable debt but only 2.5% of the total number of cases.

OUR GENERAL APPROACH

In addition to the information and help services for micro-businesses, the Tax Office also provides more detailed information and advisory services that small to medium enterprises need. For example, taxpayers can seek a private ruling from the Tax Office so they have certainty about the GST or income tax consequences of particular transactions or arrangements.

As many of the issues are complex, we focus on working with tax professional associations and industry bodies to identify areas causing taxpayers difficulty or presenting a risk to revenue. We convene a wide range of industry partnerships to facilitate a joint approach to resolving matters that concern both the Tax Office and industry.

This year the government provided the Tax Office with additional funding to undertake increased audits in this segment. As part of the program, we expect to contact over 25,000 small to medium enterprises during the year. This will involve field visits and we will also be writing to businesses requesting additional information.

The compliance risks in this segment range from micro-business issues, such as not declaring income, to those of concern in the large business segment, such as transfer pricing and loss utilisation. Non-compliance in this segment is more likely to result from a lack of knowledge of the law or from evasion, rather than from a different interpretation of the law.

Over the last decade the tax performance of this segment relative to its asset base has been improving. However, our analysis shows that in 2,000 businesses at the larger end of this segment there is an increasing gap between profitability and tax paid. We are paying particular attention to this group, with additional audits and risk analysis.

Increasingly, these businesses are engaging in international transactions that give rise to a range of specific compliance issues (see international, page 14).

Increasingly, these business are engaging in international transactions that give rise to a range of specific compliance issues.

OUR COMPLIANCE FOCUS

Inappropriate tax minimisation

We are concerned about inappropriate tax minimisation – for example, by using inflated management fees, excessive royalty payments, and tax-driven financing arrangements.

There is also evidence of incorrect claims for tax losses in this segment. This may occur as a result of other income minimisation strategies or where losses are transferred from an entity that is not part of the same wholly-owned group (see large business, page 8).

Not recording or disguising payments for labour and other supplies

Some businesses are making unrecorded payments at cheaper rates for labour and other supplies. This illegally increases their own competitiveness, and facilitates tax evasion by their workers and other suppliers. Often these unrecorded cash payments are for overtime work.

In some cases, payments for labour are disguised by using false invoices for other business expenses or invoices from fictitious labour hire firms. The payer may try to claim a tax deduction or input tax credits for these invoices without complying with pay as you go withholding and other employer obligations. This year the Tax Office will focus on these aspects of the cash economy in a wide range of industries (see the cash economy, page 20).

Manipulating insolvency rules

The Tax Office has found other cases where the price a business quotes for a job cannot return a profit once tax and other on-costs are paid.

We will continue to focus on the use of company structures to evade tax – such as 'phoenix' companies, where directors accumulate unpaid pay as you go withholding and other debts, abandon the company and its debts, and then carry on business through a newly formed company.

Since 1998 this has returned $150 million in adjusted tax assessments and penalties. By closely monitoring phoenix companies, we are identifying their practices and collecting debt earlier.

High-profile entertainers and sportspeople

The Tax Office works closely with sport and entertainment promoters to ensure non-resident entertainers and sportspeople pay their tax before they leave the country. Last year these activities resulted in $29 million in adjusted tax assessments and penalties. The Tax Office also provides assistance to domestic organisations and sportspeople to ensure they are paying the correct amount of tax and are complying with their obligations.

Other risks

Other risks include:

- distributing income from private companies through non-commercial loan arrangements
- failing to disclose capital gains
- failing to report fringe benefits
- promoting, designing or distributing aggressive tax planning schemes and arrangements
- incorrectly claiming GST credits or refunds, not disclosing cash transactions, failing to account for GST on disposal of business assets, and mis-using recipient created tax invoices (see GST, page 22), and
- claiming incorrect sales tax refunds (see GST, page 22).

Under development – *see page 5 for small to medium enterprise initiatives*

The large business segment includes about 1,000 corporate groups, each with an annual turnover exceeding $100 million. Because of similar compliance risk factors, we include high wealth individuals in this segment. The segment contributes approximately 17% of Commonwealth income tax, 55% of GST and 95% of excise revenue.

Typically, the segment is characterised by large corporations with complex structures, operating in competitive environments. It is supported by Australia's well-developed financial market, and delivers services globally. Cost-effectiveness, including tax-effectiveness, is an integral part of the competitive environment.

Multinationals are delivering services in and out of Australia and tend to follow global patterns of convergence, for example, media and telecommunications industries. They use direct dealings rather than intermediaries in the financial services industry. The benefits include economies of scale and lower overheads.

The complexity of the business world is increasingly difficult for tax administrators. Structural changes – such as mergers and takeovers, increased integration of overseas and domestic markets, new hybrid financial instruments and attendant capital restructuring – tend to obscure transactions and increase compliance risks.

OUR GENERAL APPROACH

The dynamics of the market and complexity of operations in this segment mean we need to continue our concentrated attention on these taxpayers to ensure compliance.

To some extent, risks reflect the continuing major structural changes. The value and volume of transactions are very significant and we need to make sure that taxpayers are getting it right, that they have the guidance they need, and that we are actively pursuing tax avoidance.

We provide guided help through closer relationships with key taxpayers, relevant industry bodies and tax professionals, rather than through the more extensive marketing and education programs we use in segments with larger numbers of taxpayers.

While large corporations generally use both in-house and external professionals for tax advice, there is an increasing tendency for them not to seek rulings on the tax implications of complex business transactions. This puts a premium on coverage and risk assessment in the segment. At the same time, we acknowledge the need to improve the timeliness of our advice, and we are increasing our efforts to be more responsive.

The compliance of this segment in relation to both lodgment and payment of agreed liabilities is generally very high. However, because of the complexity of the issues and the consequent challenging of our decisions by litigation, the level of disputed debt is also very high.

We have an extensive audit program for large corporations and high wealth individuals, collecting additional revenue of $2.64 billion over the last five years.

We have also significantly improved our risk assessment procedures and our focus on material discrepancies. In 2001–02 we identified risks at a faster rate than we could treat them. These risk cases are flowing into our audit program for 2002–03 and beyond, for which the government has provided more compliance resources.

The major risks presently in this sector are associated with income tax. However, across the board, we have concerns about the treatment of non-standard transactions, for example, the sale of assets for GST and capital gains tax purposes, and the adequacy of accounting and system controls for tax purposes.

In 2002–03 we plan to start a further 1,000 specific-issue audits and 150 comprehensive audits for income tax and GST.

We have an extensive audit program for large corporations and high wealth individuals, which has collected additional revenue of $2.64 billion over the last five years.

OUR COMPLIANCE FOCUS

Consolidation

The new consolidation regime is a fundamental reform of the corporate tax system and we expect that most large corporate groups will adopt the changes.

We are supporting groups entering the new system with the *Consolidation Reference Manual*, which is a comprehensive guide that includes many practical examples. Other products include fact sheets and newsletters. At the same time, we are working with large corporations to ensure that, on implementation, the results are as the government intended.

We will focus on the membership rules and the transfer and use of losses, as well as checking for unintended consequences flowing from valuation issues, as they apply to losses and asset values.

In addition, we have seen evidence of early restructuring to maximise benefits, such as creating new 'head entities' to allow potentially significant asset revaluation benefits. We will focus on identifying restructures that are contrary to the intent of the government's policy.

High wealth individuals

We will continue the comprehensive compliance program for high wealth individuals and their associated entities.

Our strategies include expanded tax returns for higher risk groups; questionnaires to individuals to update or identify associated entities; audits of higher risk groups; specific-issue audits in a range of cases; and improved technology to measure tax performance and identify compliance risks. Around 50 high wealth individuals will be subject to audit during 2002–03.

International

International dealings are an integral part of today's business. There has been a very significant increase in international transactions in recent years. Our role is to ensure that global profits are properly allocated and that Australia gets its fair share of tax (see international, page 14).

Aggressive tax planning

Aggressive tax planning risks in this segment include promoting, designing or distributing schemes and arrangements specially tailored for large corporations or business activities. The finance industry, particularly the money market, plays a key role in assisting and facilitating arrangements for their corporate clients.

Arrangements lacking economic substance and designed only to achieve contrived tax benefits are closely investigated – as are those arrangements that deliver unintended tax benefit transfers, such as the transfer of franking credits and deductions.

We are also investigating capital expenditure write-offs, the re-characterisation of gains, and the avoidance of withholding taxes though attempts to change the nature of payments.

In relation to the promoters, designers and facilitators of schemes, we are vigilant in following up on significant corporate transactions. We also pursue intelligence provided through our internal controls and external sources.

Capital gains tax

We are seeing elaborate arrangements to avoid or reduce capital gains tax in connection with corporate restructures, mergers and acquisitions. These pose a severe risk to revenue and the intent of the capital gains tax regime.

These arrangements seek to exploit capital gains tax concessions and use convoluted transactions that lead to income re-characterisation and conversion through intra-group asset transfers and dealings. Typically, they convert an accounting profit from an asset sale to a much-reduced capital gain, or even a capital loss, for tax purposes.

Our focus on capital gains tax planning has yielded large adjustments to tax returns, with capital gains tax accounting for a significant proportion of the $2.3 billion in additional tax and penalties raised in 2001–02.

Substantial further adjustments are expected again this year.

Losses

While many losses are, of course, genuine, others have been created by circumventing the loss provisions – through loss duplication, artificial loss creation and loss trafficking. Recent tax reform measures have reduced the range of opportunity for this 'loss planning'. While existing accumulated 'losses' have not been and may never be used, the size of the potential risk to revenue requires our continuing attention.

We are being particularly vigilant in the transition to the consolidation regime, as some large taxpayers may seek to re-organise their business activities to use previously 'trapped' losses or to inappropriately recoup prior year losses.

We have made substantial adjustments to intra-group arrangements seeking to artificially create losses, transfer losses to shelter group income, and obtain deductions for losses where real economic loss has not occurred.

Over the past five years, $12.8 billion in losses has been disallowed (see consolidation, page 8.)

GST

The Tax Office is increasing its audit focus in this market substantially this year because of the potential revenue at risk (see GST, page 22).

We are examining:

- inadequate accounting and system controls, leading to incorrect activity statement calculations and GST liability
- the treatment of non-standard transactions
- transactions that involve non-monetary consideration
- financial supplies, including apportionment between input taxed supplies and other supplies that may lead to overclaiming of input tax credits
- incorrect classification, leading to GST not being charged or understating of GST liability, and
- the accuracy and integrity of refunds being claimed.

Business tax reform

It is critical we support businesses in understanding the effects of business tax reform measures. We will then monitor the implementation to ensure compliance and be alert to any unintended consequences.

For example, with capital allowances, a key risk is that taxpayers are unable to track assets due to inadequate accounting and system controls. This could lead to incorrect treatment under the law, with assets being classified as consumables.

Under development – *see page 5 for large business initiatives*

This segment includes charitable, religious and community service non-profit organisations; sporting and recreational clubs; business and professional associations and trade unions; private schools; some hospitals; and some large financial and insurance companies.

Successive governments have recognised the social importance of this group, which has special status within the tax system.

While there are 700,000 organisations in this segment, only 170,000 of them are in the tax system – 94% of these are companies, and the remainder trusts. Combined annual turnover exceeds $43 billion.

The 30,000 largest organisations employ 8% of Australia's workforce. So while this segment pays less than $1 billion in tax, its role is significant because it collects large amounts of tax paid by its employees.

Tax administration can be difficult for small bodies and the voluntary officers who support them.

OUR GENERAL APPROACH

This segment has a high level of compliance. Our primary approach is relationship management, combined with help and education services.

The Tax Office manages the entitlement for charities to be income tax exempt, and to gain 'gift deductible' status. Our role is to ensure that the concessions go only to those entitled to them.

There are some highly targeted audits and checks to address specific risks, which include:

- individuals obtaining tax 'benefits' from closely held charitable trusts
- charities engaging in commercial operations, with profits potentially affecting their exempt status
- public funds and sub-trust arrangements not complying with public fund integrity requirements, putting gift deductible status at risk
- creating tax shortfalls for medical practitioners within hospital billing arrangements
- universities engaging in unusual structuring and funding arrangements that potentially affect their exempt status
- receiving a benefit from funds after claiming a deductible gift where individuals or entities have a close association with the funds, and
- organisations claiming incorrect imputation credits.

Governments

This segment includes federal, state or territory and local government bodies. There are some 25,000 organisations, most of which are exempt from income tax. Around 80% are state and territory government organisations.

Their importance to the tax system lies in the number of people they employ – around 1.3 million. Tax and superannuation obligations of more than $6 billion are withheld from these employees and passed on to the Tax Office. Most organisations also pay or claim back GST and pay fringe benefits tax.

While there is a high level of compliance, we are conscious of the need to continually review our help and education program to ensure it is appropriate and serving its purpose.

Registered tax agents are indispensable intermediaries in managing the community's tax system. Agents lodge 75% of the 10 million individual income tax returns and 98% of the 500,000 company returns. Agents also lodge 55% of activity statements.

Changes to tax law over the last few years have challenged both tax agents and the Tax Office. Agents have borne the brunt of rapid changes and the sometimes-awkward systems designs we have implemented.

The tolerance shown by agents and their part in bedding down these changes have been crucial to the continued functioning of the tax system.

Agents and their associations are telling us they need improvements, and we are quickly responding with initiatives on several fronts: rebuilding the relationship; giving agents access to and greater control over their clients' information; and providing improved levels of service.

We provide a wide range of support and education services to the 8,500 tax practices in Australia, which have around 24,000 individual registered tax agents.

There is no single voice representing the tax industry – eight associations represent agents, some agents are members of more than one association, and the majority of agents do not belong to any association.

ISSUES

The scope of recent changes in law has challenged the way tax practices have traditionally operated, with substantially increased workloads for many and a much larger number of interactions with the Tax Office each year. At the same time, we are noticing a trend towards agents adopting technologies to support their businesses and the increased demands they face.

The evolving nature of government business also presents tax practices with challenges. For example, the government offers the community choices in claiming benefits, including through the tax system. As a result, tax practices now find themselves interacting with agencies other than the Tax Office.

Our relationship with agents has two dimensions: they manage a large number of critical interactions with the tax system, including lodging, paying and checking balances; and they advise and represent taxpayers on tax issues.

Agents want these interactions to be efficient, so they can concentrate on their core work of advising clients. We provide as much help and support as possible for these interactions.

In regard to tax issues, our relationship is determined by the role agents take in advising their clients. The vast majority of agents want comfort and certainty for their clients by ensuring they meet their obligations under the law. Our relationship with these agents is straightforward and, again, supportive. Yet some clients want their agents to traverse the grey boundaries of the law. Here our relationship is different. We pursue certainty and clarity, not just for a single case, but also for others who might seek to exploit uncertainty at the expense of the broader community.

Because of their key role in the operation of the tax system, there are special registration requirements for people wanting to practise as a tax agent. Independent tax agents' boards manage the registration of agents.

The Tax Office uses intelligence from compliance activities to ensure that a particular tax agent is not encouraging or facilitating taxpayer non-compliance. We also monitor tax agents for compliance with their own tax obligations, including lodgment of income tax returns and activity statements, and payment of tax debts.

Where there is evidence that a tax agent is encouraging or facilitating non-compliance or they have poor performance in their own tax compliance, we refer the evidence to a tax agents' board. The board investigates and determines whether the tax agent can continue to be registered as a 'fit and proper person'.

Unregistered 'agents' continue to be a problem. We have projects to identify, investigate and, where appropriate, prosecute unregistered tax preparers. We also refer registered tax agents to the tax agents' boards where there is evidence that they have been providing assistance to an unregistered tax preparer.

Support for tax agents

Tax agents are offered the following dedicated services:

- priority access to call centres
- a service for unresolved or complex enquiries
- the Tax Agent Portal, launched on 3 October 2002, providing agents with secure and detailed information about their clients, and online access to new and improved products and services, including online forms that can be completed and submitted in a secure manner

- information on key administrative and legislative changes through tax agent broadcasts and satellite seminars (which have increased in popularity over the last few years and are highly regarded by participants); and a dedicated area of the Tax Office website, and
- visits from our staff designed to help agents use technology in their practice, including how to get the most out of the electronic lodgment service and Tax Office websites.

Tax agents interactions at a glance

- We expect 1.6 million calls from agents in 2002–03. Since July this year, 90% of calls from agents have been answered within two minutes.
- Two national satellite seminars were conducted in 2002, reaching a total of 24,000 agents.
- Our Tax Agent Portal provides agents with secure information about their clients and online access to products and services. Around 8,500 tax agents used the site in its first eight weeks of operation.
- Some 1,900 face-to-face presentations have helped agents with tax technical issues.
- Over 160 communiques were sent to agents in 2002, via their preferred medium (email, fax or post).
- A fortnightly electronic notice (called *e-link*) to subscribers, which includes hyperlinks to pertinent information on the Tax Office websites.
- A quarterly printed newsletter, containing topical content, sent to all agents.
- Web-based products including *Tax measures in brief* and the *Tax agent portfolio*, are designed to help keep agents up to date.
- Eighty focus groups have been conducted to encourage a better understanding of issues facing agents, and what to do about them.
- Some 200 visits to agents have helped them introduce Tax Office technologies into their practices.

Under development

Initiatives we are working on with agents fall into three groups:

- Improving our relationship by better understanding their service needs and their relationship with their clients. Around 70 senior executives in the Tax Office have visited at least three agents, listened to how their business operates, and discussed ways we can help them in their relationship with their clients. A specific initiative is to redesign their workload created by the regular cycle of submitting forms and payments.
- Giving agents greater access to and control over their clients' information through the continued development of the Tax Agent Portal. This site will evolve throughout 2003 as we work with agents and their associations to develop speedier, more responsive services.
- Providing services through dedicated relationship management officers for agents with more than 100 clients. This is currently being piloted and we plan to fully implement the service by mid-2003. Secure email will give agents speedier access on complex issues. Our website will have regular updates on our performance for agents. This will help agents plan their enquiries to our call centres.
- Improving call centre facilities so that by early 2003 tax agents will be able to return to the same officer they spoke with last time, if that officer is available.

Other initiatives and improvements for the community will also help agents and their clients (see page 5).

International issues now affect all segments – from giant corporations to backpackers.

For individuals, the lack of awareness of obligations, the transitory nature of many interactions and the tax-free threshold available only to Australian individuals are all factors that affect compliance.

For businesses, cross-border investment and income flows are increasing, while global restructuring and changes in ownership are accelerating, regardless of whether a business is large or small.

Transactions between different parts of global corporations (so-called 'related parties') continue to grow far more strongly than in the general economy. Approximately 8% of small to medium enterprises have 'related party' international dealings, valued at more than $5 billion. Over the last three years, the average value of each transaction has increased by 640% to $2.7 million.

Mobility of capital causes many countries to use their tax regimes as a competitive tool to encourage investment. At the same time, globalisation is creating greater cooperation and broader alignment of trade, environment, tax and other rules.

Paying interest overseas, particularly within corporate groups, has increased dramatically in the past few years and is trending significantly higher than interest payments into Australia.

Technology such as e-commerce has accelerated the globalisation of home-based businesses and more sophisticated operations, with more individuals now investing and transacting their affairs internationally.

OUR GENERAL APPROACH

It is essential we maintain our focus on international issues to ensure Australia obtains its fair share of tax and that global profits are properly allocated. Our key programs are:

- working with Treasury to ensure Australia's treaty program is appropriate to government policy and business needs
- ensuring Australian views are reflected in international tax forums on issues like tax havens, bank secrecy, e-commerce, treaty interpretations and transfer pricing (or value-shifting to minimise tax)
- focusing on transfer pricing through a comprehensive program of rulings, education, risk assessment, audit and advance pricing agreements
- working with other tax administrations to improve exchange of information and to better align our approaches to global compliance
- providing rulings, advice and assistance to taxpayers – we will continue the extensive international public rulings program and develop a web presence for international issues
- undertaking research and risk identification and analysis, including record and data matching, to identify and quantify patterns and trends in populations and markets, and
- working with small to medium enterprises and their advisers to improve their understanding of tax knowledge. Tax Office information indicates that 10% of these enterprises have international dealings.

Transactions with tax havens have increased 200% in the last six years. The internet is making it easier to market tax haven 'products', such as foreign life policies and offshore credit/debit cards, which can be used for fraudulent purposes.

OUR COMPLIANCE FOCUS

Tax havens

Transactions involving tax havens have increased 200% in the last six years. The internet is making it easier to market tax haven 'products', such as foreign life policies and offshore credit/debit cards, which can be used to gain easy access to money hidden in tax havens.

We are combating the use of tax havens by:

- analysing intelligence, including AUSTRAC data, to identify the use of tax havens and their promoters
- contributing to OECD work to reduce abuse of tax havens, particularly in our region, and
- cooperating with other tax administrations, law enforcement agencies and tax haven administrations to prosecute abusive transactions.

Profit shifting

Transfer pricing audits have, over the last three years, resulted in tax and penalty assessments of $655 million, and disallowed losses of $796 million.

We will continue to undertake audits of transfer pricing and to promote advance pricing agreements, which are designed to reduce the cost of compliance and give taxpayers more certainty in their business planning.

We have recently expanded our focus on transfer pricing to include small to medium enterprises. We will be reviewing over 500 taxpayers to ensure they are lodging the required declarations, and we will undertake risk assessments of the transfer pricing policies of 40 high-risk small to medium enterprises. Where necessary, we will conduct audits of the highest risk taxpayers in this group.

For large businesses we expect to complete 30 transfer pricing audits and 25 advance pricing agreements.

Apart from a continuing focus on specific industries – including motor vehicles, oil, pharmaceuticals and distributors – we will closely watch the pricing of intangibles and services. These so-called 'commissionaire' arrangements seek to move high-risk and value-added functions to low-tax countries. We will also continue to assist with the development of global approaches through the OECD.

Offshore assets

Complex arrangements involving the use of derivatives and round-robin funding are being used to avoid capital gains tax on the sale of offshore investments by Australian companies, and to exploit the exempt dividend provisions.

The general anti-avoidance provision will be used against such schemes and arrangements.

Business tax reform measures

These include thin capitalisation, debt and equity definitions, and consolidation of groups for tax purposes.

We are providing support to taxpayers affected by these new measures and working with them to ensure there are no unintended consequences.

We will analyse income tax return and thin capitalisation schedule data to identify and examine appropriate cases. This will ensure taxpayers understand and adhere to the new thin capitalisation legislation (particularly the arm's length test, and debt and equity definitions).

AGGRESSIVE TAX PLANNING

The scale and nature of aggressive tax planning continues to be a significant risk to the tax system, and remains a key priority for the Tax Office.

Much aggressive tax planning is structured around financing arrangements designed to create or inflate tax deductions. Some aggressive arrangements seek to exploit concessions in the tax law designed to encourage certain types of investments

We aim to respond quickly to aggressive tax planning by focusing on patterns, trends, drivers and leverage points, and then cautioning the community if we view arrangements to be outside the law.

OUR GENERAL APPROACH

Either alone or in combination, the Tax Office will look closely at:

- contrived and artificial arrangements
- financial arrangements with little or no underlying business activity or purpose
- the level of tax benefit claimed in realising an economic return
- an abnormally low level of economic risk faced by a taxpayer
- the contrived transfer of a tax benefit
- limited or non-recourse financing associated with a round-robin flow of funds
- limited cash outlays associated with loans that capitalise debt
- winding up or leaving an arrangement before net income is generated
- excessive valuations of assets resulting in inflated deduction claims
- use of tax-exempt entities, especially charities, to wash income, and
- transactions that involve tax havens.

Capital gains tax planning is often associated with a business event — such as a restructure, merger, acquisition or disposal of a business or asset — seemingly designed to avoid or minimise tax.

OUR COMPLIANCE FOCUS

The Tax Office is currently examining over 100 tax planning arrangements.

Cases under examination include complex arrangements designed to avoid or minimise capital gains tax, financing arrangements, and offshore arrangements using tax havens.

Capital gains tax planning is often associated with a business event – such as a restructure, merger, acquisition or disposal of a business or asset – seemingly designed to avoid or minimise tax. Another theme of capital gains tax planning concerns the valuation of assets (see large business, page 8).

We will use private and public rulings to set out our view, and litigation is expected to further clarify the law.

Some financing products or arrangements are widely marketed; others are more tailored to the circumstances of particular taxpayers. The more tailored arrangements are a greater risk to Commonwealth revenue and are the subject of closer examination by the Tax Office (see large business, page 8).

Offshore tax planning arrangements are an increasing risk. There is evidence of increased movement of funds to tax havens, including by individuals and small to medium enterprises (see international, page 14).

Promoters

Keeping in touch with what is being offered in the market is important to prevent problems escalating quickly. Monitoring and acting on the activities of promoters gives us insights into emerging developments.

We are looking closely at promoters' own tax affairs, their associates, the schemes promoted, the taxpayers who participate in the schemes, and possible criminal offences. Our strategies include:

- using the Commissioner's access powers, including unannounced visits
- requiring early lodgment and expanded tax returns for higher risk promoters
- streamlining lodgment and debt enforcement practices, and
- cooperating with the Australian Federal Police and the Commonwealth Director of Public Prosecutions on possible criminal prosecutions.

Our investigations over the last year or so reveal that promotion of tax avoidance schemes is continuing, with marketing of 'excluded offer' arrangements (which do not require disclosure under corporations law) and arrangements tailored to the circumstances of higher income taxpayers.

The financial services market is highly competitive and drives the development of innovative and so-called 'tax-effective' financial solutions.

To identify and address the more tailored tax planning arrangements, we are looking to work with the finance industry and accounting and legal firms to identify the latest tax planning products or arrangements, and to give an early view of their tax consequences.

Mass marketed investment and employee benefit schemes

We will continue to resolve (by settlement or litigation) the mass marketed investment schemes of the 1990s and employee benefit schemes. This will allow us to move to more timely action on new and emerging arrangements.

Around 36,300 taxpayers have agreed to settle outstanding tax debts for mass marketed schemes on the terms offered by the Commissioner. For the remaining 5,300 taxpayers, we will be determining outstanding objections, litigating relevant cases and collecting the outstanding tax.

Around 7,500 taxpayers entered into employee benefit schemes and we will continue to take action to resolve these cases. We expect to litigate further cases.

Taxpayer education

To improve taxpayer awareness of the issues and the potential risks surrounding aggressive tax planning, the Tax Office has a special website, **www.ato.gov.au/atp**. The website is a 'one-stop-shop' for what taxpayers should consider before putting money into a managed investment scheme or similar arrangement. It also has a list of product rulings and taxpayer alerts.

Product rulings offer certainty around the tax consequences of proposed investments or projects. Approximately 100 product rulings will be issued during the year.

Using a sample of around one-third of our product rulings, we will review the implementation of arrangements to ensure compliance.

Reporting the correct information and paying on time are fundamental to successful tax administration.

We place a high priority on helping taxpayers lodge on time and avoid debt, which can accumulate rapidly for some businesses.

Each year we process forms and payments for 15 million individual and business taxpayers. At any one time, there are more than 1 million debt cases, equivalent to 6% of clients lodging income tax returns.

We manage more than 60 million forms and payments annually, covering all taxes: income tax, pay as you go withholding and instalments, GST, fringe benefits tax, excise, wine equalisation tax, the superannuation guarantee levy and the superannuation surcharge. We also manage a small number of debts from the earlier tax system, including pay as you earn, the prescribed payments system, and sales tax. With such large volumes, debt and lodgment management requires some 3,100 staff.

After two years of transition to the new tax system, the Tax Office is returning to a more rigorous approach to lodgment and payment compliance.

Recently, we have seen a 250% increase in the volume of debt transactions, mainly due to the more frequent interaction with the tax system for most clients. For many small businesses that previously had annual obligations, the new tax system introduced quarterly obligations. These higher volumes mean debt is established earlier and, consequently, more debt is collected.

OUR GENERAL APPROACH

We aim to make early contact with clients to encourage payment and lodgment. Our approach takes account of taxpayers' lodgment and payment histories, the cost-effectiveness of our actions, and opportunities to influence behaviour. This leads to an escalating process of intervention for debt and lodgment.

According to compliance profile and risk priority, during 2002–03, we will:

- contact all clients by letter, 28 days after they are due to lodge information or make a payment
- follow-up by phone where clients do not respond to written requests
- visit clients who do not respond to alternate strategies, and
- prosecute for non-lodgment, and undertake legal action for payment where appropriate, and where other solutions have been exhausted.

In addition to our escalating intervention strategies, we encourage compliance by:

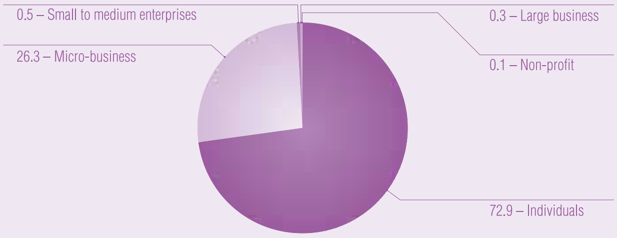
- applying the general interest charge on outstanding payments and notifying clients through monthly running balance account statements
- applying a failure-to-lodge-on-time penalty, taking into account previous lodgment behaviour (We will send a warning letter to clients before applying a penalty.)
- regularly issuing a statement notifying clients of changes to their tax account
- monitoring and managing large business clients, with particular emphasis on pay as you go withholding commitments; these clients are contacted by phone when non-payment is detected
- examining behaviour in high-risk cases and categories – for example, we have a special focus on small to medium enterprises, which represent 2% of debt cases but 19% of debt by value, and
- focusing on lodgment of income tax returns for self-managed superannuation funds and superannuation guarantee debt.

Initial contact usually results in an agreement to pay – either in full or over a negotiated period – and agreement to lodge forms and information. There is a continuing focus on prompt enforcement action against persistent debtors, including those in the legal, medical and accounting professions.

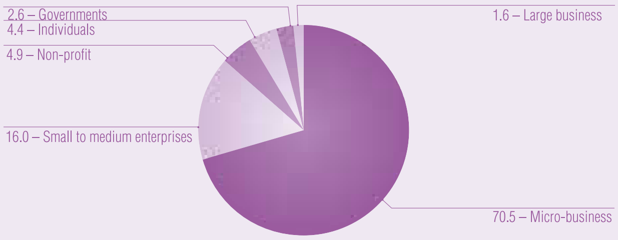
Many taxpayers are facing severe hardship as the drought affects farmers and rural communities. The mass marketed tax schemes of the mid-1990s left large tax debts for many unsophisticated investors. Our approach in these cases is much more sympathetic and accommodating; depending on individual circumstances, we can waive interest and delay collection, while still encouraging lodgment.

ACTIVITIES PREDICTED FOR 2002–03

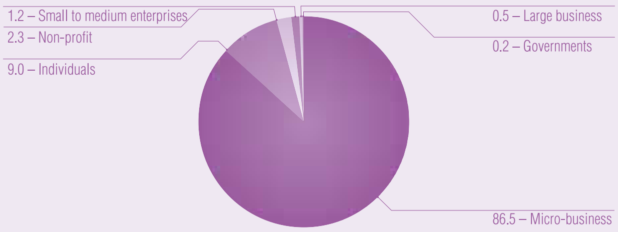
15 million income tax returns by segment (%)



4.5 million monthly activity statements by segment (%)

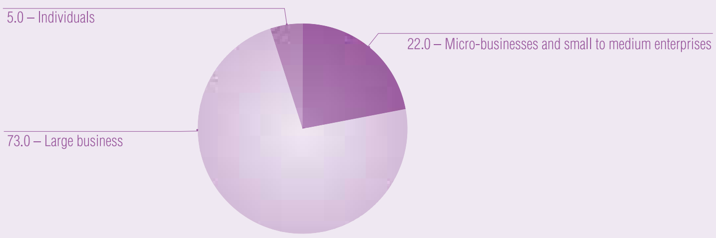


Over 9 million activity statements by segment (%)



In 2001–02, $31.5 billion collected from more than 1 million debt cases by segment (%)

$8 billion in disputed debt, mostly income tax, by segment (%)



THE CASH ECONOMY

The new tax system has significantly enhanced our ability to detect those people who avoid their tax responsibilities. Businesses must now have an ABN to deal with other businesses – or have 48.5% of any payments made to them withheld.

Since the start of the new tax system in July 2000, around $70 million has been withheld from payments to businesses not quoting their ABN. Some 30% of amounts withheld are not being claimed back.

Valid tax invoices are needed to claim GST credits, and businesses must now report on a more regular basis, keeping our data up to date.

While these changes significantly address the issues in business-to-business transactions, the Tax Office faces a different challenge in dealing with cash transactions between businesses and consumers. We are looking to engage the community and industry associations to improve compliance in this area. This year the Cash Economy Task Force will recommend further strategies to address this problem.

OUR COMPLIANCE FOCUS

The cash economy takes many forms, from employees moonlighting to larger scale practices – such as businesses 'skimming the till', disguising transactions and creating false invoices, or operating wholly outside the tax system.

While the cash economy has an obvious impact on tax collections, it is also felt at a more grass roots level, with businesses that are doing the right thing disadvantaged by those avoiding their tax obligations. This is one of the reasons why the community often tip off the Tax Office about people who are doing the wrong thing. Last year we received 40,000 calls to our 1800 060 062 tax evasion hotline, resulting in $44 million worth of amended tax assessments and penalties.

Last year we received 40,000 calls to our 1800 060 062 tax evasion hotline, resulting in $44 million worth of amended tax assessments and penalties.

To identify those in the cash economy, we use a range of strategies. For example, ABN registrations are cross-checked with income tax lodgments; GST turnover and input tax credits are compared to income and expenses; and financial ratios obtained from activity statements and tax returns are compared across similar types of businesses.

The Tax Office also acts on information provided by the community and other government agencies. Of particular value are the reports of significant and suspicious cash transactions and overseas money transfers provided by AUSTRAC under the Financial Transactions Reports Act. We also undertake random checks to assess the level of risk across different areas.

We are expanding our cash economy strategies as part of our 2002–03 compliance program, as follows:

- over 85,000 businesses whose financial performance is markedly different from their industry peers will be contacted as part of our investigations into undeclared income
- around 20,000 businesses can expect a visit from one of our 600 officers specialising in detecting omitted income and businesses operating outside the tax system, and
- a further 2,400 field officers will identify cash economy issues as part of their general compliance reviews.

High-risk industries now being closely scrutinised include building and construction; road freight services; taxis; cafes, restaurants and takeaway food outlets; hairdressing and beauty salons; cleaning services; clothing and textiles; pubs, clubs and taverns; and the security industry.

Other industries set to face tighter scrutiny include second-hand car dealers; the fishing industry; liquor retailing; gold bullion; antique dealers; art dealers; and the tourism industry.

We are paying special attention to illegally grown tobacco and its manufacture into 'chop chop' (see excise, page 25).

Checks undertaken since the start of the new tax system have also identified tens of thousands of businesses that appear to have been operating without lodging income tax returns. Most of these are micro-businesses and we are pursuing their tax returns.

EVASION AND FRAUD

Some people in the community take decisions to deliberately not comply with the tax law. They may, for example, refuse to provide access to our officers, fail to provide information when required to do so, disguise transactions or destroy documents, use false registrations, or simply refuse to lodge tax returns or meet other obligations.

Dealing effectively with this kind of behaviour is essential to building community confidence that the tax system operates fairly. Of course, it is also a compliance issue in itself.

These kinds of matters are handled by auditors who specialise in dealing with uncooperative taxpayers and their advisers. They work closely with law enforcement agencies in this work, including the Australian Federal Police and the National Crime Authority.

Last year these auditors conducted 594 tax audits that resulted in amended tax assessments and penalties of around $90 million.

In cases where there is evidence of fraud or other illegal activity, another team of specialised investigators establishes whether it is appropriate to refer the matter to the Director of Public Prosecutions. Last year we investigated 308 income tax, sales tax and GST matters for possible prosecution action, and 121 prosecutions were completed. These matters included 60 prison sentences.

Investigations into this kind of behaviour are also undertaken as part of our excise and superannuation compliance activities (see excise and superannuation, pages 25 and 26).

OUR GENERAL APPROACH

We are continuing to improve on how we can 'stay in front of the game' in this fast changing area of dealing with serious non-compliance with the tax law.

A dedicated group of 275 investigators is working on these serious matters. Over the coming year we plan to increase this group to 300. Their work involves:

- undertaking comprehensive audits to identify fraud activity
- analysing intelligence from income tax returns, activity statements and other taxpayer returns, as well as analysing significant cash transactions and international movement of funds
- working with other law enforcement agencies to share intelligence and target illegal activity
- undertaking risk assessments
- investigating fraud in cases where there is evidence of fraud, and
- referring cases to the Director of Public Prosecutions.

GOODS AND SERVICES TAX

The GST is a broad-based tax of 10% on the supply of most goods and services in Australia. Last year the Tax Office collected $26 billion in GST.

GST is charged at each step in the production and distribution chain, with a registered business including GST in the final price paid by the consumer. The business then claims a credit for the GST included in the price it paid for goods and services.

In this way, GST is collected only on the value added by each business in the production and distribution chain, with the tax ultimately paid by the consumer.

There are 2.2 million businesses registered for GST, including charities and other non-profit organisations that previously had no tax obligations or dealings with the Tax Office.

A third of GST-registered businesses have an annual turnover of less than $50,000 and 93% have a turnover of less than $1 million. Just 1% have a turnover of more than $20 million.

OUR GENERAL APPROACH

In line with international experience with value-added taxes, we have a program that supports the community with help and education, combined with broad coverage and high-visibility compliance checks.

This is important in our self-assessment system because recurring monthly or quarterly liabilities can rapidly escalate if obligations are avoided or mistakes made.

Our compliance program is not just about identifying incorrect or avoided tax; it is also designed to provide assurance that the GST system is working as intended, and that our education program is targeted and effective.

Audits

We employ a range of approaches under the banner of 'audits', including letters to taxpayers requesting specific information; direct phone contact with taxpayers or agents; and field audits. A field audit may involve a simple review of a taxpayer's record keeping practices, an inquiry on a specific issue such as a refund claim or the sale of a business asset, a review of all the obligations reported on a particular activity statement, or a full audit of a taxpayer's obligations.

A third of GST-registered businesses have an annual turnover of less than $50,000 and 93% have a turnover of less than $1 million. Just 1% have a turnover of more than $20 million.

In 2001–02 our audit program targeted 9% of GST-registered businesses and resulted in $363 million additional GST being paid.

This year we will increase the number of GST compliance staff by around 350, and our audit program will focus more on medium and large businesses. Around one in ten businesses will be subject to some form of audit.

OUR COMPLIANCE FOCUS

Fraudulent or incorrect claims for refunds

This is a major risk for the GST system. Incorrect claims for refunds can result from genuine misunderstanding of entitlements, bookkeeping errors or deliberate attempts to evade tax. At the extreme, frauds are sometimes attempted through the use of false documentation or bogus business registrations.

Our challenge is to help businesses with their cash flow by issuing refunds as quickly as possible, while preventing incorrect payments. We have extensive checks and processes in place to meet this challenge, with more than 90% of refunds paid within 14 days. We pay interest if we do not meet this 14-day standard for genuine refunds.

During 2001–02 we delayed for review more than 67,000 refunds worth $17 billion, disallowing claims of $101 million as a result.

There were five prosecutions for fraud, with a further 38 cases referred to the Director of Public Prosecutions or other law enforcement agencies.

The cash economy

Non-disclosure of cash transactions is a major issue, and the Tax Office has specialist investigation teams to deal with all GST and income tax implications of this behaviour. This year we will conduct around 20,000 field visits related to the cash economy. As well, field officers examine cash transactions as part of all compliance reviews (see the cash economy, page 20).

Businesses not understanding their obligations

Given the widespread application of GST and the significant number of very small and new businesses in the system, a major risk is that these businesses do not understand their obligations. For this reason, we provide a comprehensive help and education program.

This year we expect 840,000 phone requests for advice and 12,500 written requests for advice or private rulings. This represents a significant reduction in requests for advice on GST, down from 2 million calls and 17,500 written requests in 2001–02. This is a clear indication that our help and education program has been successful and that businesses are becoming more familiar with their GST obligations.

We will, however, be continuing our highly successful program of free advisory visits. We have 50,000 visits planned for this year, aimed mainly at new businesses to help them with record keeping and provide general advice.

In 2001–02 we responded to 760 requests to speak at seminars and workshops, distributed 770,000 GST publications, and received 75 million hits on our website. We will continue to respond to requests for speakers and to provide a high-quality suite of information products.

Inadequate accounting and system controls in large businesses

Large businesses generally have tailored and sophisticated accounting systems to manage their GST obligations. Keeping these systems up to date with changes to the law and business circumstances is both a challenge and a risk to compliance, particularly given the large amount of revenue generated by these businesses. As well, most accounting systems do not automatically account for non-standard transactions, such as property sales.

The Tax Office is addressing these risks with increased audits of medium and large businesses. This year we will conduct 23 full audits and 1,000 audits of specific issues in the large business segment.

Sales of business assets

GST is payable on the sale of any business assets, even if they were acquired before GST was introduced in July 2000. Our experience shows that many businesses fail to account for tax on these sales because they are outside the normal scope of business trading.

We use information on asset sales from income tax returns, as well as other information such as motor vehicle registrations, to identify possible liabilities.

To address this issue, we will contact over 10,000 businesses by phone or letter, asking them to provide further details and make any necessary adjustments. Follow-up field audits will be conducted to resolve any outstanding issues.

Recipient created invoices

In some circumstances the recipient of a supply, or an intermediary, may generate tax invoices on behalf of the actual supplier. This occurs where the final price of goods or services supplied to another person may not be easily determined by the supplier (for example, where livestock is provided by a primary producer to a meat processor). There is a major risk that businesses could manipulate this process to generate false input tax credits for themselves. Taxpayers operating under this arrangement are monitored closely and audits are conducted on a regular basis.

Property and business services industry

Businesses involved in property and business services are included in our cash economy compliance program because of the prevalence of cash transactions in that industry.

We maintain an extra focus on this industry because it has been one of the fastest growing sectors – around 24% of total GST registrations – and because of the special rules that apply to property transactions under the GST law.

Banking, finance and insurance industry

This industry is also subject to a special focus because of the complexity of the special rules that apply under the GST law.

Businesses in this industry generally make a combination of taxable, tax-free and input taxed sales. They are not entitled to credits (or are entitled to only a reduced credit) for GST included in the price of goods and services they purchase to make input taxed sales. These special rules can result in quite complex arrangements to identify credit entitlements and are a major compliance risk.

The non-profit and government segment

For many non-profit and government organisations, GST represents their first exposure to a significant tax liability. Government organisations at all levels have been required to implement new accounting systems and controls, and to review their activities to identify potential liabilities and ensure that entitlements to input tax credits are properly documented. Many of the community-based non-profit organisations rely mainly on volunteer staff and need support from the Tax Office to understand their obligations and entitlements. One common mistake by non-profit organisations is to fail to account for GST on government grants.

Our main approach in this segment is to advise organisations of their obligations. We have worked closely with the Australian National Audit Office in developing guides for better tax accounting practices for government agencies. We also work closely with those agencies to develop targeted information products for the community-based organisations they deal with.

We support this help and education program with an active field presence. This year we will conduct 2,400 audits in this segment.

Sales tax

Wholesale sales tax ceased when GST was introduced. However, under the law, taxpayers may continue to claim refunds of sales tax overpaid for up to three years. There is a risk that refund claims might be inflated in the belief that the attention of the Tax Office will be on managing the new tax system.

We review sales tax refund claims and undertake field audits where necessary. In 2001–02 nearly 30% of refund claims were disallowed, with a value of $38 million.

Luxury car tax

Luxury car tax is payable on that part of the value of a vehicle that exceeds the car depreciation limit. Luxury car tax obligations are reviewed in conjunction with GST verification checks.

In 2001–02, around 1,100 registered taxpayers accounted for $220 million in luxury car tax.

Excise duty is levied on domestic production of alcohol, tobacco and petroleum products, generally based on their volume. The Tax Office also administers wine equalisation tax, which is a value-based tax imposed on the wholesale price of wine.

Excise is a significant component of the retail price, and this can drive illegal behaviour to avoid its collection. Strict controls track the movement of products to protect Commonwealth revenue.

Excise accounts for 13% of Commonwealth revenue, or around $20 billion a year. The excise system also delivers grants and rebates as a means by which the government reduces the costs of fuel for particular industry and business sectors (such as mining, transport or agriculture) or in particular geographical areas. In 2001–02 rebates and grants of $3 billion were paid to over 200,000 clients. We also administer the product stewardship (oil) scheme, aimed at encouraging recycling and disposal of waste oil on behalf of Environment Australia.

While 205 companies pay excise, just 20 contribute 99% of the revenue.

Approximately $640 million in wine equalisation tax is collected annually from 1,600 wineries and wholesalers.

OUR GENERAL APPROACH

We have a range of education and advisory strategies, including one-on-one visits, brochures, bulletins, industry liaison and presentations, and a dedicated call centre answering around 240,000 phone enquiries a year.

We also conduct a range of audits.

Excise revenue is also controlled through annual licensing of 800 manufacturers and producers in the petroleum, tobacco and alcohol industries. Licensing allows us to limit the quantity of production or storage, as well as restrict the movement of products on which excise has not been paid (for example, alcohol for industrial use). These licences may be cancelled in cases involving serious evasion.

While 205 companies pay excise, just 20 contribute 99% of the revenue.

OUR COMPLIANCE FOCUS

Claiming ineligible or overstated fuel rebate and grant payments

Not paying, incorrectly paying, or being late in paying excise and wine equalisation tax, and incorrectly classifying products

We conduct audits to confirm the accuracy of returns and payments. This financial year we will complete 1,200 educational and focused audits.

Our processing systems check all claims for payment against a range of risk criteria, and our staff review all claims that meet these criteria. We will check 160,000 claims this year and make any adjustments before payment.

Diverting alcohol intended for manufacturing or industrial purposes into the beverage market to avoid excise

We issue 2,200 permits for the use of alcohol in the non-beverage market. We ensure these clients are aware of their obligations by providing education, and auditing high-risk clients where there is a greater risk of evasion through diversion back into the beverage market.

Illegally growing tobacco and manufacturing it into 'chop chop' to avoid excise duty

Our investigative staff respond to fraudulent or illegal activities, which may result in penalties or prosecution. The focus of this activity has been the tobacco and petroleum markets.

Most of our current activity is addressing excise evasion in the tobacco market, with 48 search and 38 seizure warrants being executed to the end of October 2002. We have seized over 19 tonnes of tobacco leaf and cut tobacco (commonly referred to as 'chop chop') to date.

Since September 2000 we have seized large amounts of cash, over 170 tonnes of tobacco, 23 cutting machines, and 31 motor vehicles. We have also issued 139 penalty infringement notices for retail sales. Around $45 million in excise would have been evaded if these activities had gone unchecked.

There are over 130 cases pending prosecution with the Director of Public Prosecutions. We also work closely with other law enforcement agencies, including the state and federal police forces, in cases involving serious crime.

Substituting fuel products that have lower or nil excise rates (for example, heating oil, kerosene, methanol and vegetable oils) with petrol or diesel to avoid 38 cents per litre excise

To minimise the loss of revenue through fuel substitution, we have a fuel testing program to detect fuel blends on which no excise has been paid. We also consult the petroleum industry to assess the incidence of fuel substitution. As part of our ongoing program, we have carried out 2,860 tests at 793 retail sites throughout Australia over the last year.

The Tax Office plays a pivotal role in administering the superannuation industry, including regulating self-managed superannuation funds. The industry now has around $530 billion in superannuation fund assets under management.

The government has recently announced a range of new policies to supplement existing measures.

The superannuation guarantee was introduced 10 years ago and forms the compulsory element of the government's retirement income system. It covers 90% of Australians, with employers contributing around $30 billion each year.

Around 99% of employers pay superannuation for their employees (although some make minor errors), with the balance of employers not paying anything.

The number of self-managed superannuation funds has grown by almost 25% over the last three years to around 240,000 funds, with approximately $95 billion under management. We receive 1,000 new registrations each month, making this the fastest growing sector of the industry. There are around 408,000 people with accounts, with an average balance of $234,000. In net terms, approximately $10 billion flowed into self-managed funds during 2001–02.

With Australians taking a greater interest in their superannuation and retirement plans, the rate of enquiries to the Tax Office is increasing.

The Tax Office also contributes directly to the superannuation system through:

- maintaining the Lost Members Register, a register of people who have become 'separated' from their superannuation funds. At the end of October 2002, the register held approximately $6.5 billion in 4.2 million member accounts, and
- administering the Superannuation Holding Accounts Reserve, which employers use to pay small superannuation amounts for employees. At the end of October 2002, the balance of the reserve was approximately $55 million. It has had around 150,000 depositors since its inception in July 1995, with 34% using it more than once.

OUR GENERAL APPROACH

Our compliance approach has a strong help focus, supported by enforcement.

We work closely with community stakeholders such as industry associations, professional advisers, trustees and members to tailor education programs that raise awareness and understanding.

We provide help and education through approximately 800,000 phone enquiries, 60,000 written enquiries, 300 private rulings, and self-help from our website (760,000 hits expected annually) and fax back services.

We provide information in the monthly *Superupdate* newsletter (circulation 12,000); up to 100 personal presentations at seminars, industry conferences, trade shows and media presentations; calls to some 4,500 new trustees; mailout of educational materials to 30,000 trustees; and over 300 other information products.

Our enforcement activities involve superannuation funds, trustees, employers and employees, tax professionals, financial advisers and industry bodies. Our activities are underpinned by computer links with other government agencies such as Centrelink and the Department of Immigration and Multicultural and Indigenous Affairs.

OUR COMPLIANCE FOCUS

Up to 10,000 employers not making superannuation guarantee payments for their employees

These are usually small businesses with less than 10 employees, whose failure to pay generally extends over several years. Our surveys indicate up to a further 240,000 employers get it mostly right but make minor errors. Overall, up to 500,000 employees may not be receiving their correct entitlements.

Our program includes:

- checking more than 10 million individual payment summaries against surcharge and income tax data. We expect to audit 15,500 employers and contact a further 50,000 who are at risk of being partially or fully non-compliant. We expect to prosecute around 200 who refuse to provide information, and
- investigating all cases where employees notify us that their employer has not paid superannuation for them. We expect around 12,000 cases this year.

Inappropriate schemes and mismanagement of self-managed funds

Some trustees of self-managed funds and their advisers are not correctly managing their superannuation responsibilities, for example, not lodging regulatory returns or investing for the sole purpose of retirement.

Promoters are marketing schemes offering early access to benefits that have been accumulated with concessional tax treatment on the basis that they are used for retirement income. The schemes often involve investments that fail to meet the criteria.

Our program includes:

- reviewing 5,000 self-managed funds that have breached investment restrictions
- phoning all new trustees of self-managed funds and/or providing them with a new trustee guide
- being on the education panels of self-managed fund industry bodies
- providing up to 100 seminars and presentations to advisers of self-managed funds
- profiling auditors of self-managed funds to gauge their proficiency and target help and other strategies to ensure reliability of audit findings
- attending industry seminars and monitoring publications for indications of schemes
- referring promoters of schemes to the Australian Securities and Investments Commission for prosecution
- enforcing lodgment of 53,000 outstanding tax and regulatory returns
- conducting a benchmark compliance survey of 700 funds, which will be used for broader analysis, and
- following up all regulatory returns that have audit qualifications.

The number of self-managed superannuation funds has grown by almost 25% over the last three years to around 240,000 funds, with approximately $95 billion under management. We receive 1,000 new registrations each month, making this the fastest growing sector of the industry.

Avoiding or delaying the superannuation surcharge

The Tax Office collects the superannuation surcharge from more than 400,000 high-income earners. We have identified 7,000 taxpayers with superannuation contributions of more than $10,000 who have not lodged returns and are preventing surcharge and other assessments being raised. Many of these people would be subject to the surcharge. There are also lower income tax earners in a similar position.

Some 20,000 super funds are not reporting contributions for the surcharge, thereby delaying surcharge assessments and collection of revenue.

Our program includes:

- enforcing lodgment of around 40,000 income tax returns to allow assessments to be raised
- enforcing lodgment of around 20,000 surcharge member contribution statements, and
- ensuring reportable fringe benefits amounts are included on income tax returns.

Funds not reporting lost members

We have identified around 100 funds that have not reported lost members, so their details are not recorded on the Lost Members Register. This makes it more difficult for individuals to be re-united with their superannuation savings, resulting in increased government outlays on pensions and other benefits.

Our program includes:

- enforcing Lost Members Register reporting for non-reporting superannuation funds
- raising awareness of the register in the community, for example, through the Unclaimed Super Recovery Project, and
- offering a product called Supermatch that allows superannuation funds to check members' details against the register.

Over the last 12 months this has re-united more than 500,000 members with their lost super, and we expect this level of performance to continue.

Not lodging or incorrectly lodging tax returns

The Tax Office manages income tax compliance for around 250,000 superannuation funds.

Our program includes reviewing the lodgment and correctness of tax returns and surcharge member contribution statements for around 500 large funds and 50,000 smaller funds.

The ATO Plan 2002–03 is made up of four sub-plans: compliance, operations, people and place, and information technology.

The sub-plans are designed to enable us to deliver our agreed outputs and are guided by our corporate priorities.

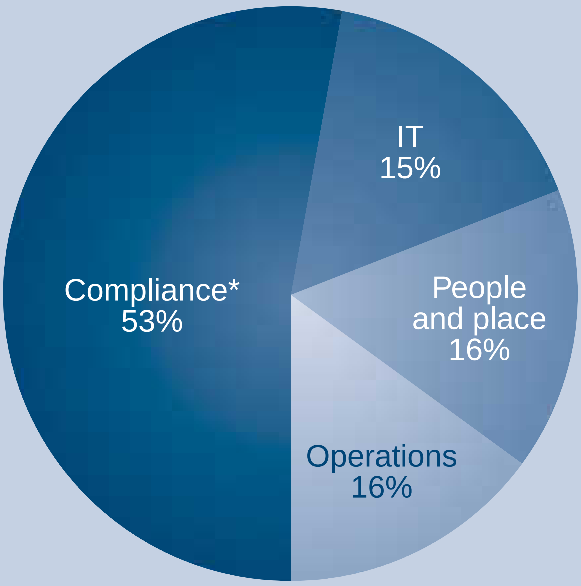
The compliance sub-plan is central to our effective revenue administration, while the other three sub-plans play a supporting role.

Underpinning all the sub-plans is the aim to treat taxpayers in accordance with the *Taxpayers' Charter* and the Compliance Model.

The sub-plans will evolve throughout 2002–03 as a result of a number of factors. These include internal and external feedback, new policy, revised risk assessments, business design and initiatives such as Listening to the Community. This initiative is an ongoing consultation program with tax practitioners and the community designed to make complying with the tax law easier, cheaper and more personalised.

The interdependence of the sub-plans also means that we must continually assess, monitor and review them to ensure we make any necessary resource shifts within and between the sub-plans.

This chart shows how we have allocated resources between the four sub-plans.



*Including debt and lodgment managed by the Operations Executive

Operations sub-plan

The operations sub-plan aims to provide practical support for our compliance work by achieving debt targets and budgeted tax collections. Work under this sub-plan involves activities such as registrations, payment and product processing, client accounting, and debt collection and lodgment enforcement. Very large transactional volumes for all Tax Office operations account for the major part of this sub-plan.

The sub-plan is specifically focused on listening to and co-designing with clients and stakeholders to improve their interaction with the tax system. This includes, among other things, eliminating errors, reducing backlogs, providing simpler ways for taxpayers to meet their tax obligations, and harmonising our products, systems and services.

People and place sub-plan

The major aim of the people and place sub-plan is to provide a sustainable platform to deliver our business outcomes and adapt to needs and opportunities in a rapidly changing environment.

The sub-plan does this by:

- supporting our people through the provision of skilling programs, addressing wellbeing issues and work and job design, and encouraging a culture of integrity and performance
- ensuring we have appropriate, safe, healthy and secure work places, and
- enhancing our corporate planning processes.

Information technology sub-plan

The information technology sub-plan aims to provide the information technology architecture and design, applications, infrastructure, security, and future planning needed to support our compliance work.

The sub-plan particularly aims to make more efficient use of technology through synergies between projects and processes, and keep pace with external developments and community expectations.

Executive

Strategic statement and plan

- Approve our strategic statement and plan
- Continue to develop strategic directions
- Monitor overall delivery and initiate corrective action
- Approve necessary shifts between sub-plans

Corporate Design Forum
Review and contribute to the development of our strategic directions and corresponding capabilities.

Tax Policy Coordination Committee
Joint Treasury–ATO forum to manage the policy agenda.

Plenary Governance Forum
Quarterly meeting of executives to review progress against the direction and sub-plan.

Corporate steering committees/forums
Review and drive particular corporate initiatives and capabilities.

Rulings Panel and other panels
Establish our position on major technical and litigation issues.

Compliance Executive

Compliance sub-plan

Design and deliver the Tax Office's compliance program.

Administer income tax (including benefit distribution), fringe benefits tax and superannuation, GST, excise collection and distribution systems.

Develop and implement a range of services covering help and education, including a frontline advice and interpretation service for taxpayers and their advisers to help them meet their obligations.

Maintain the integrity of the tax system with appropriate verification, audit and enforcement activities.

Operations Executive

Operations sub-plan

Design and deliver the Tax Office's operations program.

Manage client accounts from registration through to their lodgment and payment obligations.

Design and manage the Tax Office's accounting and registration systems, manage payment and product processing, and debt lodgment.

IT Executive

IT sub-plan

Design, build and maintain the Tax Office's corporate business systems to support operations and compliance activities.

Plan and manage the provision of information technology and telecommunications services.

People and Place Executive

People and place sub-plan

Support the delivery of compliance, operations and IT sub-plans through communication and relationship strategies. This includes planning for the workforce required to deliver today and for the future through recruitment, skilling and performance management programs.

Audit Committee
Oversee risk assessment and assurance activities (previously internal audit), internal controls for risk management and financial reporting, and the implementation of Australian National Audit Office and risk assessment and assurance recommendations.

Integrity Advisory Committee
Advise on the way we promote and support an ethically-based culture to fulfil the principles of the Australian Public Service code of conduct and the *Taxpayers' Charter*.

Finance Committee
Review progress against the budget. Recommend corrective action. Develop our financial management capability. Monitor impact on future years.

Business and service lines
Plan and manage delivery of sub-plans within lines, reflecting decisions and directions from executive bodies.

Contact information

Please send your comments on this program to:

Compliance feedback
PO Box 655
Civic Square
ACT 2608

or email to:
compliance.feedback@ato.gov.au

NAT7769-12-2002