

Level 2, 95 Pitt Street  
Sydney NSW 2000

Tel: 02 8223 0000  
Fax: 02 8223 0077

Email: [tia@taxinstitute.com.au](mailto:tia@taxinstitute.com.au)

**ABN: 45 008 392 372**

[www.taxinstitute.com.au](http://www.taxinstitute.com.au)



1 March 2011

Mr Ali Noroozi  
Inspector General of Taxation  
Level 19  
50 Bridge Street  
Sydney, NSW 2000

By email: [submissions@igt.gov.au](mailto:submissions@igt.gov.au)

Dear Mr Noroozi

### **Work Program Consultation**

The Taxation Institute of Australia (**Taxation Institute**) welcomes the opportunity to assist in the development of the Inspector General of Taxation's (**IGT**) work program for 2011 and beyond.

The Taxation Institute is Australia's leading professional association in tax. Working together with the tax profession, we aim to improve the tax system and the delivery of tax services through education, sharing of information and consultation. We consider that the IGT's role in the tax system is invaluable. We look forward to continuing to work with the IGT to improve the tax administration system to the benefit of taxpayers and their advisers.

### **Overview**

In this submission, we have set out a number of key areas where we recommend that the IGT should focus its work program for 2011 and beyond. We recognise that there are a plethora of administration issues facing the tax system, and we have chosen to focus on the top issues that have faced our members in recent times. However, we are supportive of the IGT conducting reviews into other systemic administrative issues and will be supportive of working with the IGT where it is possible for us to do so.

On a broad level, we note that the IGT's current practice is to set the forward work program two years in advance. We suggest that, if it is at all possible, the IGT set the work program for the next 12 months rather than two years. This should allow the IGT to be more responsive to important current issues and allow a more flexible approach to the work program.

## Suggested areas of focus

### ***Small business benchmarks and cash economy audits***

The Taxation Institute has continually received complaints and concerns regarding the ATO's "cash economy" audit program and the application of the "small business benchmarks".

The ATO's cash economy audit program is set out in detail in its 2010-11 Compliance Program.<sup>1</sup> The program is focussed on "micro businesses" – that is, businesses that are very small and often run as owner-operators.<sup>2</sup> There are approximately 2.7 million micro businesses operating in Australia and about 95% of them lodge their returns through tax agents.<sup>3</sup> The ATO states that its cash economy audit activities will see over 26,000 micro businesses reviewed and audited.

The ATO uses information matching "*extensively*" and uses "*sophisticated profiling tools*" in the course of identifying micro businesses for review and in the process of its audits. One particular tool is the use of the small business benchmarks. The ATO states that the benchmarks are "*designed to help businesses compare their performance against similar businesses and provide them with guidance on what we would normally expect to see in their reporting*".

The ATO has published benchmarks for over 100 different business types. Benchmarks are divided into three categories:

- Performance benchmarks, covering ratios such as cost of goods sold to turnover;
- Cash sales benchmarks, which measure the ratio of cash sales to total sales; and
- Input benchmarks, which show an expected range of income for trades people based on the labour and materials they use.

The benchmarks are published on the ATO's website, so that taxpayers can compare their own performance to the industry benchmarks.

The ATO states that around 100,000 micro businesses will be contacted in 2010-11 because their reporting income is outside the published benchmark ranges. The ATO has commenced this strategy by writing to the affected taxpayers and their agents, and informing them that they should review their record-keeping practice to ensure they have correctly met their tax obligations.

Our members have raised a number of concerns with the ATO's strategy.

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<sup>1</sup> A copy of the program is available on the [ATO website](#) – refer to publication reference NAT 7769.

<sup>2</sup> We acknowledge that the IGT's current work program includes a review into the ATO's small and medium enterprise audit and risk review policies, procedures and practices (as per the terms of reference announced in April 2010). However, the terms of reference for that review specify that the IFT will review aspects of SMEs with annual turnovers between \$100 million and \$250 million. Therefore, this review would not have covered micro enterprises.

<sup>3</sup> ATO Compliance program 2010-11, page 12

Firstly, our members' greatest concerns rest with how the ATO develops and applies the benchmarks.

The ATO has stated that the benchmarks are developed from the income tax returns and activities statements of businesses reporting income up to \$15 million turnover in the relevant industry. The ATO states that it uses a number of sources to determine an industry, including the ANZSIC business industry codes, descriptions on income tax returns, the trading name of a business and relevant third party data (for example, from banks). All of the benchmarks are updated annually.<sup>4</sup>

Our members are concerned that benchmarks sometimes appear to be inappropriate. There are concerns that the peculiarities of certain business within an "industry", which may affect a benchmark ratio, are not adequately taken into account. There are concerns that benchmarks are not refined appropriately to take into account regional differences – that is, businesses will have different financial performance depending on whether they are located in a city, suburban/metropolitan area, regional centre or rural location. There are also concerns that benchmarks formulated at one point in time may quickly become outdated due to changing economic conditions or market trends. Overall, the concern appears to be that some benchmarks are not refined such that they can be applied to individual businesses.

Another concern arises around the way the ATO communicates its compliance strategy. The recipients of the cash economy letters are often small business people whose business is their livelihood. Being singled out for a possible ATO review can cause a great deal of stress for these business people and their adviser. We acknowledge that it is vital for the ATO to continue its compliance program; however, we would like the IGT to investigate the success of the current compliance approach and whether the communication of the strategy (and the level of understanding of the strategy) in the small business community can be improved.

Finally, our members are deeply concerned that the benchmarks could be used inappropriately to issue deemed notices of amended assessment. We urge the IGT to investigate whether and/or how benchmarks are used in this way, and whether it is fair and/or accurate to do so.

### ***ATO's service standards***

The ATO has a number of service standards that are designed to assure the ATO and the community that the services provided by the ATO are of a *"consistent and high standard"*. The service standards are a level of performance that taxpayers and their advisers can *"expect when dealing with [the ATO] under normal circumstances"*.<sup>5</sup>

The service standards are typically timeframes in which a taxpayer (or its adviser) can expect to receive a response or action from the ATO. For example, the service standards state that if a taxpayer lodges an income tax return electronically, the ATO will aim to process it within 14 days of receipt. The ATO's stated benchmark (in 2010-11) for this service standard is 94%. As well as for lodgements, service standards have been put in place for processing of registrations, refunds and payments, enquiries, amendments and objections, audits, errors and complaints.

The service standards have been in place for a number of years, and are a useful benchmark for judging the ATO's performance in a selected area over a certain period

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<sup>4</sup> "Cash Economy – Frequently Asked Questions" document, available on the [ATO website](#)

<sup>5</sup> A description of the ATO's service standards is available on the [ATO website](#).

of time. We consider that the role of service standards in shaping the taxpayer (and tax adviser) community's expectations for dealing with the ATO should be examined.

As acknowledged by the IGT in its 2009-10 annual report:

*The IGT reviews, in particular the Change Program review, have raised certain issues around service standards. This issue also arises in other ATO product delivery context.*

*... it would be useful to consider the purpose of service standards and who they should serve, along with the impact analysis for all stakeholders including interactions with other government agencies.*

The Taxation Institute supports the IGT's position in this regard. As stated above, the ATO's own material acknowledges that the service standards are designed for the ATO's own monitoring of its performance, as well as for the community at large.

Problems arise when the service standards are not met. During the implementation of the Change Program, the lodgement processing service standards were not met for many taxpayers. This led to inconvenience, anxiety and in some cases, financial loss, for taxpayers and their advisers. We acknowledge that the ATO's conduct during the implementation of the income tax release of the Change Program has already been subject to an IGT review, and we do not propose for the findings of that review to be re-examined. Rather, we propose that the use of service standards generally (i.e. not just in lodgement cases) be examined.

It may also be worthwhile examining the ATO's communications regarding the service standards and how they can be used in the evaluation of the ATO's performance in a particular area.

Finally, there may be aspects of the ATO's service standards that are touched upon in the IGT's review of the Change Program, which are not fully explored in that report (as they may not be completely within scope). To the extent that issues with the service standards are not fully addressed in the Change Program report, we encourage the IGT to review them in detail in a separate review.

### ***ATO's practice of outsourcing of its debt collection function***

The ATO's practice of outsourcing some of its debt collection functions has been a top concern for many of our members in the SME sector.

The ATO announced an external debt collection services panel in 2007<sup>6</sup> and has continued the practice of outsourcing some of its debt collection. This is particularly the case for small debts in the SME sector, as well as collection of superannuation guarantee payments.

The collection agencies that are contracted to undertake the debt collection work are agents of the Commonwealth, and are subject to the same privacy and security requirements as the ATO.<sup>7</sup> The collection agencies are provided with taxpayer data, such as name, contact details and account balance, such that the agency can pursue the debt with the taxpayer.

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<sup>6</sup> Refer to ATO media release Number 2007/148.

<sup>7</sup> Refer to ATO Tax Practitioner Forum minutes of August 2008, agenda item 5, available on the [ATO website](#).

Our members concerns are around the appropriateness of using third party contractors to conduct the ATO's functions. We recognise that the ATO has put in place policies and procedures designed to ensure that the contracted agencies act with integrity and within the scope of the law; however, it is the level of *adherence* to those policies and procedures that concern our members. Specifically, there are concerns with the contact that is made with taxpayers directly (as opposed to via the taxpayer's tax agent), the timing of the calls from the agency and the currency of the debtor information that the agency uses.

We note that the IGT briefly commented upon outsourcing of debt collection functions in its "*Review into the Tax Office's small business debt collection policies and practices: Summary of submissions and evidence*".<sup>8</sup> However, at that stage (in April 2005), the ATO had not undertaken any outsourcing of its debt collection function (and incidentally stated that this would "*not be considered before the implementation of [the] 'Change Program'*"). As the outsourcing practice has been in operation for several years and has not been reviewed by the IGT, we submit that it is an apt time for its effectiveness and validity to be reviewed.

### **Concluding remarks**

As noted in our opening remarks, there are many issues facing the tax administration system and selecting the priority issues for review is difficult. There are a number of other issues that we have not canvassed in this submission, as we have chosen to focus on the priority issues for our members. However, should the IGT select other issues for the work program, we would be more than happy to provide submissions and assistance as required.

If you have any questions regarding the issues we have raised, please contact me on 03 9288 6677 or the Taxation Institute's Tax Counsel, Tamera Lang, on 02 8223 0059.

Yours sincerely

A handwritten signature in cursive script, appearing to read 'Peter Murray'.

Peter Murray  
President

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<sup>8</sup>

Refer to paragraphs 6.69 to 6.73.