

The Auditor-General

Sales Tax

Australian Taxation Office

Australian National Audit Office

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Canberra ACT
4 December 1997

Dear Madam President
Dear Mr Speaker

In accordance with the authority contained in the *Audit Act 1901*, the Australian National Audit Office has undertaken a performance audit in the Australian Taxation Office and I present this report and the accompanying brochure to the Parliament. The report is titled *Sales Tax, Australian Taxation Office*.

Yours sincerely



P. J. Barrett
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the Audit Act to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

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ACS	Australian Customs Service
AGPS	Australian Government Publishing Service
AIS	Australian Taxation Office Integrated System
ANAO	Australian National Audit Office
ATO	Australian Taxation Office
CaMRA	Case Management, Reporting and Analysis tool
CEO	Chief Executive Officer
COMPILE	Customs Online Method of Producing Invoices from Lodgable Entries
CRMS	Case Reporting and Management System
CRS	Case Reporting System
CTE	Centres for Technical Excellence
Dob-in	The process whereby the ATO is alerted by members of the public about suspected sales tax avoidance
Drawbacks	Sales tax refunds issued by the Australian Customs Service
EFT	Electronic Funds Transfer
Grapevine	ATO business system consisting of a technical database and communication/message facilities
HOTSA	Health Of The System Assessment
HRD	Human Resource Development
I&E	Inform and Educate
INB	Individuals Non-Business business line
ISYS	Text retrieval software that enables word and phrase searches of a sales tax technical database
IRW	Interest Royalty Withholding
LB&I	Large Business and International business line

MOU	Memorandum Of Understanding
NOMAD	National Organisational Management Database
NSTLC	National Sales Tax Liaison Committee
OPS	Operational Performance Standards
PAYE	Pay As You Earn
PPS	Prescribed Payments System
RTST	Regional Technical Support Team
SBI	Small Business Income business line
SME	Small/Medium Established team
SST	Streamlined Sales Tax legislation
STAA	Sales Tax Assessment Act
TAXLAN	Taxation Local Area Network
TTD	Tax Technical Database
TTRF	Tax Technical Research Facility
WHT	Withholding and Indirect Taxes business line
WST	Wholesale Sales Tax

Part One

Summary and Recommendations

1.
 2. The Australian Taxation Office (ATO) is the Commonwealth's principal revenue collection agency, collecting \$107 billion in taxation revenue during 1996-97. Sales tax is an appreciable component of this tax revenue, with net ATO collections totalling \$12.7 billion in 1996-97. The Australian Customs Service (ACS) collected an additional \$600m in sales tax on behalf of the ATO on goods imported into Australia during the same year.¹
 3. Sales tax (also known as wholesale sales tax) is imposed on goods manufactured in, or imported into Australia. It does not apply to goods already 'applied to own use'² in Australia, nor a range of exempt goods (for example, most food and clothing). The broad aim of sales tax law is to tax the last wholesale sale of goods (usually the sale from the last wholesaler to the retailer). The law provides a quoting³ system designed to avoid tax becoming payable on earlier sales. A system of credits deals with (among other things) situations where sales tax has become payable more than once on the same goods.
 4. The sales tax law is widely acknowledged as complex in its application. Such complexity increases the risk that taxpayers will not understand their obligations and therefore fail to meet their sales tax obligations. The inherent risks associated with the complexity of the sales tax system become more pronounced as taxpayers apply it to the variety of

¹ The ACS collects sales tax on behalf of the ATO on goods imported into Australia.

² 'Applied to own use' is a term used in sales tax legislation and can be defined as consuming goods, giving them away, leasing them, using them in manufacture or granting a right or permission to use them.

³ A person who 'quotes' their sales tax number (or an exemption declaration) does not pay sales tax on the goods they are acquiring. The law contains a precise set of rules detailing when exemption may be claimed by quoting.

circumstances arising from contemporary business dealings.

5. The ATO has developed a business and service line organisational structure⁴ to manage its diverse responsibilities. Within this structure the Withholding and Indirect Taxes (WHT) Business Line is responsible for administering sales tax as well as the Pay As You Earn (PAYE) system, the Prescribed Payments System (PPS) and several smaller taxes.

6. Sales tax, also known as wholesale sales tax, was first introduced into Australia in 1930 with regular amendments being made to the legislation since then. In 1992, the sales tax legislation was rewritten and reorganised into a new package of legislation referred to as the Streamlined Sales Tax (SST) legislation. This legislation has continued to evolve with a number of amendments being introduced and passed in recent years to address compliance issues, legal issues and the High Court ruling on state business franchise fees.

7. The issues and recommendations in this report are relevant to the evolving sales tax system and the administration of indirect taxes in general.

The audit approach

1.1

8. The objective of the audit was to ascertain how efficiently and effectively the ATO administers sales tax collections. The audit excluded an examination of the ACS's sales tax administration, although it did examine coordination and liaison arrangements between the ATO and the ACS.

⁴ This structure is outlined at Appendix 3.

9. Sales tax was of interest because it generates a significant amount of revenue, is complex in nature and has not been the subject of a comprehensive independent review for several years.

10. The audit approach involved analysing the ATO's performance against the five elements of the ATO's established compliance improvement process, namely:

- interpreting and clarifying sales tax law;
- identifying and understanding clients and markets (enabling tax officers to identify and analyse risks of non-compliance);
- providing education and information to clients regarding sales tax obligations, based on identified compliance risks;
- implementing administrative arrangements which ensure and/or assist taxpayers to meet their obligations; and
- detecting non-compliance and taking action to remedy instances of non-compliance.

11. The framework for analysis also included skills development of sales tax staff and planning, coordinating and monitoring sales tax activities.

12. In designing this framework, the ANAO took into account external factors which affect the ATO's administration of sales tax, including coordination and liaison between the ATO and the ACS.

Overall audit conclusion

13. The ANAO concluded that there is scope for improvement in the efficiency and effectiveness of the ATO's administration of sales tax collections, particularly in:

- providing technical advice and education to clients;
- undertaking appropriate market research;
- ensuring compliance with sales tax laws; and
- coordinating activities between the ATO and the ACS.

Providing technical advice and education

14. The audit revealed that WHT had initiated enhancements in its sales tax technical advising arrangements and associated training and client education. It is expected that this activity will result in better compliance. However, the ANAO considers that the collection of sales tax would be further improved if WHT:

- adopted a national approach to quality assurance in provision of technical sales tax advice; and
- developed and implemented a national education strategy.

Undertaking market research

15. WHT restructured its operational activities to focus on market segments that have different compliance characteristics. However, the absence of market research support specialists and clear market research guidelines for staff has hampered WHT's progress in improving its market knowledge. Greater use of business systems to store and manage information regarding client markets would assist with the identification of better practices in market research and the more efficient management of information. In addition, we concluded that the lack of information provided by taxpayers has impeded WHT's capacity to effectively monitor sales tax compliance. The ANAO recommended that the ATO investigate the costs to

taxpayers of providing additional information, such as the basis of determining liability, through sales tax returns.

Ensuring compliance

16. There has been a significant reduction in both the number and total dollar return of sales tax audits during recent years. The ANAO concluded that the lack of fieldwork coverage, combined with limited information being provided to the ATO after registration, has significantly undermined the ATO's capacity to maintain the integrity of the sales tax system. The ANAO therefore recommended that the ATO assesses the scope for reallocating resources to sales tax audit activities.

17. The ANAO also identified scope for improvement in the quality and relevance of information contained in the sales tax audit database. This would assist compliance strategy decision-making processes. The ANAO considered that the ATO would benefit from improving the management of 'dob-ins' from the community (regarding potential sales tax avoidance activity) and concluded that there is a significant risk that late lodgment penalties are not being imposed in accordance with legislation.

Coordinating activities between the ATO and the ACS

18. The ANAO found that there was significant scope for improvement in this area and, until recently, the coordination between the ATO and ACS had been limited. However, the ANAO noted that during the audit the ATO and the ACS convened a liaison committee and entered into a Memorandum of Understanding to formalise coordination arrangements. The ANAO made several recommendations about improved targeting of joint compliance activities for ACS clients and the identification of common compliance support activities. The ANAO also found that approximately five per cent of sales tax numbers quoted to the ACS for exemption purposes were either invalid or potentially invalid. The

quotation of invalid sales tax numbers (to enable tax-free importation of goods) is illegal. The ANAO recommended the agencies take appropriate corrective action and implement effective arrangements to reduce the incidence of future acceptance of invalid and therefore illegal quotations.

**Interpreting and
communicating
sales tax law**
(Chapter 2)

Compliance improvement process

19. Sales tax law is complex in its application. Consequently, over one-third of sales tax staff resources are committed to interpretation of the law and providing technical advice. The ANAO noted that in recent years, the ATO has issued a number of public rulings and determinations to clarify the law for the community. In identifying and setting priorities in the issues dealt with in rulings and determinations, WHT consulted industry and professional bodies extensively via the National Sales Tax Liaison Committee. The ANAO recognises WHT's efforts in recent years with regard to this initiative.

20. The ANAO found that WHT had already commenced improvements in a number of business systems and structures to assist support staff tasked with providing technical advice (including private rulings). The ANAO noted that some fine-tuning of the integrated system was required for better results and that a nationally coordinated approach to quality assurance would help the implementation and ongoing management of the integrated system. Such an approach would also provide valuable feedback to assist in identifying opportunities for further improvement of the sales tax technical program.

Identifying clients with obligations (managing risks using market research)
(Chapter 3)

21. In 1996 WHT acknowledged that a lack of market knowledge was hampering its efforts to identify and manage compliance risks. As a result, WHT restructured into segments to allow teams to focus on particular client groups. The ANAO considers this is a positive step towards addressing this risk.

22. However, a significant improvement in WHT's market knowledge has been hindered by the absence of specialist teams and supporting guidelines to assist market analysis. Specialist teams and supporting guidelines would enable staff to make the best use of client information by helping them to define issues which require clarification, conduct research and structure information. In addition, the use of business systems would facilitate the exchange and identification of better research practices between teams, branches, segments and business lines.

23. The ANAO noted that the ATO received minimal information from taxpayers regarding their sales tax liabilities. Although it is important that the costs to the community of providing (and the costs to the ATO of collecting) this information are minimised, it is an essential element in monitoring and managing risks to sales tax compliance. The ANAO considers that an examination of the record-keeping practices of sales tax payers would help the ATO identify the availability and cost associated with collecting such information.

Educating clients
(Chapter 4)

24. The ANAO noted that WHT has increased the number, consistency and technical accuracy of sales tax educational products in recent years. Initiatives involving the use of automated facsimiles and the Internet were also noted. The ANAO considers, however, that WHT could expect better compliance outcomes if it placed greater emphasis on developing and implementing a national education strategy. Such a strategy would improve the identification, development and targeting of education material based on identified risks to compliance.

Providing administrative arrangements
(Chapter 5)

25. WHT has several sales tax administrative arrangements in place including those for sales tax registrations, refunds and payments. Registration is a key arrangement as taxpayers can use their registration number to purchase goods exempt from sales tax. It also provides WHT with a mechanism for obtaining key information for compliance management. The ANAO found that WHT had begun to reform the registration process to improve compliance management.

26. However, the ANAO considers that nationally consistent vetting procedures and a cost-effective quality assurance program for the sales tax registration process would improve WHT's capacity to detect those applicants who do not satisfy legislated registration grounds. This would also reduce the likelihood of such taxpayers receiving a registration number which could be used to obtain exemptions. Similarly, as the number of registrations continues to grow substantially each year, we consider that WHT would benefit from introducing measures that enable it to verify whether taxpayers continue to satisfy registration requirements.

**Ensuring
compliance**
(Chapter 6)

27. WHT has several methods for ensuring compliance ranging from full-scale audits (involving a thorough examination of all aspects of a taxpayer's sales tax affairs) to more remote or limited contact such as phone calls or letters. Sales tax audit resources within the ATO have been steadily declining in recent years. In the view of the ANAO, this has undermined the ATO's capacity to detect and bring to account sales tax properly payable. Other ANAO concerns centred around deficiencies in the reliability and relevance of information contained in the sales tax audit database.

28. A significant proportion of current audit activity results from 'dob-ins' from the community. The audit concluded that the absence of a comprehensive national policy limits the ATO's capacity to make effective use of the information provided by informants. The ANAO also found that the introduction of a systematic quality assurance program, aimed at identifying sub-standard sales tax audit practices, would contribute significantly to the development of consistent and effective audit activities.

29. The ANAO examined WHT's performance with regard to applying late lodgment penalties (late payment penalties were examined in our November 1996 report on Tax Debt Collection).⁵ The ANAO concluded that there is a significant risk that late lodgment penalties are not being imposed in accordance with the legislation and the Commissioner's ruling on sales tax penalties. Primarily, this results from the inability of the current business system to automatically calculate such penalties. The ANAO recommended that the ATO considers remedial action as part of its current review of the late lodgment and late payment penalty provisions of tax laws.

⁵ ATO Tax Debt Collection, Audit Report No.13, 1996–97.

Compliance Support

Ensuring staff have relevant skills (Chapter 7)

30. WHT has implemented training programs to enable staff involved with sales tax duties to develop necessary technical and general administrative skills. In particular, WHT has invested significant resources to develop a technical sales tax training curriculum. However, we noted that although a draft sales tax audit training manual was substantially completed in 1994 the audit training program had yet to be fully implemented.

Planning, coordinating and monitoring (Chapter 8)

31. WHT has evaluated its planning process resulting in improvements to its 1997–98 strategic plan. WHT has also recently restructured its operations to improve accountability and control. However, we consider that further benefit will be realised by:

- ensuring that individual accountabilities are assigned for all proposed measures; and
- incorporating milestones for implementation of specific strategies and/or projects in WHT plans.

32. The ANAO also noted that current Operational Performance Standards (OPS) focus on outputs (such as items processed) rather than outcome measures (such as the effect of key strategic compliance initiatives on revenue). The challenge for WHT is to develop more appropriate and reliable outcome measures, such as the effect on revenue of certain compliance activities. The ANAO consider that establishing outcome measures on key strategic compliance initiatives would be a cost-effective means of supplementing performance information.

Coordination with the ACS on sales tax

Coordination between the ATO and the ACS (Chapter 9)

33. In 1996–97 the ACS collected on behalf of the ATO approximately \$600 million of sales tax revenue on imports. During the audit the agencies developed a Memorandum of Understanding for cooperation on sales tax matters which included the establishment of a liaison committee.

34. Our analysis of the ACS's sales tax client population revealed that a relatively small number of importers and brokers accounted for a significant proportion of sales tax revenue collected by the ACS. This provided opportunities for specific coordinated compliance activities targeted at these taxpayers. The ANAO concluded that greater coordination of support activities, such as training and system testing, would result in greater efficiency and effectiveness.

35. Importers seeking to import goods free of sales tax can quote sales tax registration numbers to the ACS. The ANAO found that in 1996–97 approximately five per cent of numbers quoted to the ACS were either invalid, or potentially invalid, and that there is a high probability that exemptions granted in these circumstances were illegal. The relatively high number of these quotations to the ACS undermines the integrity of the sales tax system and is a potentially serious risk to the revenue. The ANAO recommended that the agencies investigate the extent of false quotations to the ACS and where appropriate, take corrective action. The ANAO suggested the ACS and ATO implement data matching arrangements to reduce the incidence of invalid sales tax numbers being quoted in the future.

Acknowledgments

36. The ANAO would like to express its thanks to the ATO for providing a secondee to the audit team, and to ATO and ACS officers who assisted in the conduct of this audit. The positive attitude and expertise of these officers greatly assisted the audit and the preparation of this report.

Set out below are the ANAO's recommendations with Report paragraph references and the ATO and ACS abbreviated responses. More detailed responses are shown in the body of the report.. The ANAO considers that the ATO should give priority to Recommendations Nos. 2, 3, 4, 8, 9, 12 and 16. We also consider that the ATO together with the ACS should give priority to Recommendations Nos. 18, 20 and 21.

**Recommendation
No.1**

Para. 2.37

The ANAO *recommends* that WHT develop and implement a nationally coordinated sales tax technical quality assurance program. The program should take advantage of the efficiencies associated with business system automation of case selection for quality assurance and the existing Regional Technical Support Team network for review.

ATO response: Agreed

**Recommendation
No.2**

Para. 3.17

The ANAO *recommends* that WHT conduct research into the record keeping practices of sales tax clients. The aim of this research is to establish the costs to taxpayers of providing additional information to the ATO, such as the basis of determining liability, through sales tax returns.

ATO response: Agreed

**Recommendation
No.3**

Para. 3.28

The ANAO *recommends* that WHT develop and implement cost-effective guidelines and reference material for staff whose duties include market research and risk identification directed at improving compliance.

ATO response: Agreed

**Recommendation
No.4**

Para. 3.34

The ANAO *recommends* that WHT develop and implement a cost-effective database for maintaining market research reports and practices to help identify better practices and promote information sharing.

ATO response: Agreed

**Recommendation
No.5**

Para. 3.40

The ANAO *recommends* that WHT improve its access to internal and external market research specialists to coordinate, train and assist those staff undertaking market research.

ATO response: Agreed

**Recommendation
No.6**

Para. 4.11

The ANAO *recommends* that WHT give priority to developing and implementing a national education strategy for identifying, developing, targeting and reviewing sales tax educational products.

ATO response: Agreed

**Recommendation
No.7**

Para. 5.18

The ANAO *recommends* that WHT introduce nationally consistent vetting procedures and a cost-effective quality assurance program for the sales tax registration process.

ATO response: Agreed

**Recommendation
No.8**

Para. 5.25

The ANAO *recommends* that as part of its research into reforming the registration process, WHT develop the capacity to cost-effectively verify whether taxpayers continue to satisfy registration requirements.

ATO response: Agreed

**Recommendation
No.9**

Para. 6.14

The ANAO *recommends* that the ATO assess the scope for reallocating resources to the sales tax audit program.

ATO response: Agreed

**Recommendation
No.10**

Para. 6.23

The ANAO *recommends* that WHT develop the capacity of its business systems to record and report the effects of the sales tax audit program on liabilities and revenue.

ATO response: Agreed

**Recommendation
No.11**

Para. 6.28

The ANAO *recommends* that WHT develop and implement a data quality policy for the sales tax audit database, including clear business rules for the entry of data and a program for monitoring data quality.

ATO response: Agreed

**Recommendation
No.12**

Para. 6.35

The ANAO *recommends* that WHT develop a national policy for the management of sales tax 'dob-ins' from the community.

ATO response: Agreed

**Recommendation
No.13**

Para. 6.39

The ANAO *recommends* that WHT develop and implement a cost-effective sales tax audit quality assurance program. This program should take advantage of the efficiencies associated with case selection via the sales tax database.

ATO response: Agreed

**Recommendation
No.14**

Para. 6.53

The ANAO *recommends* that, subject to the outcome of the ATO late lodgment and late payment penalty review, the ATO develop business systems' capacity to automatically impose sales tax late lodgment penalties (section 96).

ATO response: Agreed

**Recommendation
No.15**

Para. 8.10

The ANAO *recommends* future WHT planning documentation incorporate individual responsibility for all measures and milestones for the achievement of specific compliance initiatives, where appropriate.

ATO response: Agreed

**Recommendation
No.16**

Para. 8.22

The ANAO *recommends* that to supplement existing Operational Performance Standards, WHT give priority to developing outcome measures, such as the effect on revenue, for key strategic compliance initiatives.

ATO response: Agreed

**Recommendation
No.17**

Para. 9.23

The ANAO *recommends* that the ACS and the ATO develop specific arrangements to coordinate the compliance management of the limited number of large ACS sales tax clients.

ATO response: Agreed

ACS response: Agreed

**Recommendation
No.18**

Para. 9.28

The ANAO *recommends* that joint ATO/ACS sales tax compliance activities, such as education directed at customs brokers and COMPILE users, be targeted based on analysis of the ACS sales tax client population.

ATO response: Agreed

ACS response: Agreed

**Recommendation
No.19**

Para. 9.37

The ANAO *recommends* that the ACS and the ATO review their respective sales tax support activities for commonalities and better practices to ensure greater efficiency and effectiveness.

ATO response: Agreed

ACS response: Agreed

**Recommendation
No.20**

Para. 9.46

The ANAO *recommends* that the ACS and the ATO investigate the extent of false quotations (of sales tax numbers) to the ACS for exemption purposes and where appropriate take corrective action.

ATO response: Agreed

ACS response: Agreed

**Recommendation
No.21**

Para. 9.52

The ANAO *recommends* that the ATO and the ACS establish a program for cross-matching sales tax numbers quoted to the ACS to reduce the incidence of invalid sales tax numbers being quoted for exemption purposes.

ATO response: Agreed

ACS response: Agreed

Part Two

Audit Findings and Conclusions

2.

This chapter describes the background to the audit, sets out the audit approach, objective and methodology and gives a brief overview of the operating environment in which sales tax is administered. It also provides an estimate of the resources devoted to sales tax administration.

Background

Australian Taxation Office

- 2.1** The Australian Taxation Office (ATO) is the Commonwealth's principal revenue collection agency. In 1996–97 the ATO collected tax revenue totalling \$107 billion. Net Sales tax collections⁶ during this time totalled \$13.3 billion with the ATO collecting \$12.7 billion and the Australian Customs Service (ACS) collecting approximately an additional \$600 million on the ATO's behalf on goods imported into Australia. Table 1 below illustrates the relative significance of sales tax as a source of tax revenue for government in recent years and the importance of maintaining an efficient and effective sales tax administrative system.

Table 1:
Sales tax collections and total taxation revenue

	1992-93	1993-94	1994-95	1995-96	1996-97
Net sales tax revenue (\$ billion)	9 252	10 414	11 624	12 955	13 308
Total tax revenue (\$ billion)	89 434	94 024	105 687	116 386	125 807
Sales tax/total revenue (per cent)	10.3	11.1	11.0	11.1	10.6

Note: Above figures represent total Commonwealth taxation revenues, not just those collected by the ATO. The ATO collects sales tax and, pursuant to provisions in the STAA, provides credits in certain circumstances. Taxpayers can deduct these credits from their liabilities before paying the net amount, (thus reducing collections) or may apply to the ATO for a refund. In 1996–97, the ATO received \$13.1 billion in payments (liabilities with some credits deducted) and refunded \$0.4 billion. In addition, the ACS collected \$0.6 billion of sales tax resulting in net sales tax collections for 1996–97 of \$13.3 billion.

⁶ The net figure provided is sales tax payments less sales tax refunds.

Sales tax in brief

- 2.2** Sales tax, also known as wholesale sales tax, was first introduced into Australia in 1930. It is a tax on goods that are manufactured in, or imported into Australia. It does not apply to goods that have already been 'applied to own use'⁷ in Australia. Similarly, some goods, for example most food and clothing, are always exempt from sales tax.
- 2.3** The broad aim of sales tax law is to tax the last wholesale sale of goods (usually the sale from the last wholesaler to the retailer). The law provides a quoting⁸ system designed to avoid tax becoming payable on earlier sales. A system of credits deals with (among other things) situations where sales tax has become payable more than once on the same goods.
- 2.4** Although the most common taxing point is a wholesale sale, sales tax law also applies in other circumstances. For example, sales tax may be payable if the manufacturer sells the goods by retail, arranges to lease the goods or uses the goods instead of selling them.
- 2.5** The following example (Diagram 1), which is incorporated in the sales tax legislation, illustrates how sales tax affects a typical chain of sales involving an 'ordinary good', being a chair manufactured in Australia. The example assumes that no exemption item⁹ is available and the 12 per cent tax rate applies.

⁷ 'Applied to own use' is a term used in sales tax legislation and can be defined as consuming goods, giving them away, leasing them, using them in manufacture or granting a right or permission to use them.

⁸ A person who 'quotes' their sales tax number (or an exemption declaration) does not pay sales tax on the goods they are acquiring. The law contains a precise set of rules detailing when exemption may be claimed by quoting.

⁹ Exemption Items are listed in Schedule 1 to the *Sales Tax (Exemptions and Classifications) Act 1992*. There are 195 Items, each specifying particular goods and/or circumstances in which goods may be exempt from sales tax.

Diagram 1:

Example of how sales tax may effect a typical chain of sales for a chair

2.6

2.7 The above example shows a basic sequence of transactions giving rise to a sales tax liability. In ascertaining the existence and the amount of liability for each of these transactions, taxpayers follow a basic decision-making process. This process involves determining whether the goods can be subject to tax, whether there is a taxable transaction with the goods and then calculating how much tax should be paid. Appendix 1 describes this process in greater detail. For instance, in the above example, the wholesaler who has self-assessed a \$12 liability on the sale of the chair to the retailer would have made the following decisions to ascertain this liability:

- the chair is an assessable good (broadly, 'assessable' means taxable) (step 1 in Appendix 1);
- the sale of the 'assessable' chair to the retailer is an assessable dealing (step 2);
- no exemption applies to the sale of the chair (step 3);
- the taxable value of the chair in the case of this sale is \$100 (step 4);
- no part of the taxable value of the chair is exempt, therefore the taxable value of the chair remains at \$100 (step 5);
- the chair attracts a rate of 12 per cent and therefore the liability is \$12 (12 per cent of \$100) (step 6); and
- \$12 is sent to the ATO as required by the payment rules in the law. The taxpayer is also required to satisfy other rules, for example, submitting a periodic sales tax return (steps 7 and 8).

The 1992 Streamlined Sales Tax legislation

2.8 The sales tax system (outlined above) has remained broadly the same since its inception in 1930. Although the essential features of sales tax have been retained, the legislation was rewritten and reorganised in 1992 to reduce its volume, replace obscure provisions and produce a more logical legislative framework expressed in plain English.¹⁰ The new legislation has become known as the Streamlined Sales Tax (SST) legislation and consists of the following core Acts:

- *Sales Tax Assessment Act 1992*, defines the circumstances in which sales tax is payable and contains rules about ancillary matters such as registration, quoting and time for payment;

¹⁰ The rewritten law came into effect on 1 January 1993.

- *Sales Tax (Exemptions and Classifications) Act 1992* contains a list goods that are exempt, either generally or in particular situations, and also sets out the rates of sales tax that apply to different classes of goods;
- *Sales Tax Amendment (Transitional) Act 1992* terminates the operation of the previous sales tax law and deals with the transition from the previous sales tax law to the new sales tax law; and
- the following Acts, which formally impose sales tax (and are separate Acts for constitutional reasons):
 - *Sales Tax Imposition (Customs) Act 1992*;
 - *Sales Tax Imposition (Excise) Act 1992*; and
 - *Sales Tax Imposition (General) Act 1992*.

2.9 Sales tax law is also affected by legislation that is not specific to sales tax, for example, the *Taxation Administration Act 1953*.

2.10 The issues and recommendations in this report are relevant to the evolving sales tax system and the administration of indirect taxes in general.

Audit objective and methodology

2.11 The objective of the audit was to ascertain how efficiently and effectively the ATO administers sales tax collections. The audit excluded an examination of the ACS's sales tax administration, although it did examine coordination and liaison arrangements between the ATO and the ACS.

2.12 The ANAO established a framework for analysing the approach taken by the ATO to administering the sales tax system, based on five criteria for a tax compliance improvement process as applied to sales tax. The criteria were:

- interpreting and clarifying of sales tax law;
- identification and knowledge of clients and markets (enabling tax officers to identify and analyse risks of non-compliance);
- provision of education and information regarding sales tax obligations to clients, based on identified compliance risks;

- implementation of administrative arrangements which ensure and/or assist taxpayers to meet their obligations; and
- detection of non-compliance and action to remedy instances detected.

2.13 The framework for analysis also included the following two support areas that assist the management of this process:

- skill development of sales tax staff; and
- planning, coordinating and monitoring sales tax activities.

2.14 In designing this framework the ANAO took into account those areas which affected the efficiency and effectiveness of the ATO's administration of the sales tax system and the coordination of sales tax administration between the ATO and the ACS. Diagram 2 illustrates this framework and its coverage in the report.

Diagram 2:

Framework for analysis of sales tax administration

2.15

2.16 The audit field work was conducted between November 1996 and June 1997. The ANAO examined an extensive range of material and extracted data for analysis from several ATO and ACS business systems. Fieldwork was carried out in the ACS national office, ATO national office and within ATO branch offices in New South Wales, Queensland and Victoria. The ANAO also conducted a survey targeted at WHT teams which administer sales tax. The purpose of this survey was to estimate the cost of administering sales tax and to seek information on the nature of sales tax activities (see paragraph 1.36).

2.17 During the course of the audit the ANAO consulted taxpayer and professional bodies including the Australian Society of Certified Practicing Accountants, the Institute of Chartered Accountants, the Australian Taxation Studies Program (University of New South Wales) and sales tax consultants. The audit benefited from advice on market research from a consultant, Mr Bill Godfrey, a former Second Commissioner of Taxation, with experience in market research into compliance issues.

2.18 The audit was conducted in accordance with ANAO auditing standards and cost the ANAO \$430 000. In addition, the ATO seconded to the audit team a senior officer with sales tax technical expertise at an estimated direct salary cost to the ATO of \$20 000.

Other reviews

2.19 The ATO's internal audit staff conducted a review of sales tax refund processing in 1996–97. The results of this review are reported in Chapter 5.

Context

2.20 Certain aspects of sales tax law and the operating environment of sales tax administration influence the selection of compliance strategies that the ATO may adopt to ensure the collection of properly payable sales tax.

Features of the system

2.21 Three major characteristics of the sales tax system that influence the ATO's compliance strategies are its:

- self-assessing nature;
- relative complexity; and
- transactional basis (it is a tax where a liability arises as a result of a dealing with goods, for example, a sale or a lease).

Self-assessment

2.22 Sales tax has always been a self-assessed tax, requiring taxpayers to calculate their liability and pay it, without the safety net of tax administrators validating the tax liability of every taxable dealing. The onus is on taxpayers to understand how the legislation applies to their day-to-day business transactions.

2.23 Under self-assessment, non-compliance is likely where taxpayers are unaware or unsure of their obligations, or believe that the ATO's enforcement strategies are inadequate. The education of taxpayers is a major compliance strategy for the ATO which was reviewed as part of the audit, the results of which are reported in Chapter 4. Similarly, Chapter 6 outlines the ATO's sales tax enforcement activities.

Complexity

2.24 The sales tax law is widely acknowledged as complex in its application. For instance, the report of the Small Business Deregulation Task Force, *Time for Business*, (released in November 1996), specifically refers to the complexity of the classification and exemption structure of the sales tax law. Such complexity raises the risk that taxpayers will not understand their obligations and therefore might fail to comply. The inherent risks associated with the complexity of the sales tax system become more pronounced as taxpayers apply it to the diverse circumstances arising in modern business dealings.

2.25 There may be several issues associated with dealings with ordinary goods (such as the chair used in the example in Diagram 1) which may complicate the process of determining the amount of sales tax payable. These often require careful consideration by taxpayers and the ATO. A list of some of these issues and their sales tax implications is provided in Appendix 2. The following are common examples of the complexities taxpayers and the ATO face on a regular basis:

- identifying the taxing point and assigning a taxable value to the goods at that point;
- ascertaining whether the goods are exempt or any part of the value of the goods is exempt; and
- determining the rate of tax that applies to the taxable part of the taxable value.

2.26 The advent of sophisticated market structures and distribution channels combined with new products and innovative packaging techniques has made the application of sales tax law increasingly difficult. For example:

- mobile phones are typically sold as part of a goods/services package. The goods (the phone itself and any accessories) are taxable at the rate of 22 per cent (unless an exemption applies). The fees for access to the network and other services are not taxable because they are not goods. The challenge for taxpayers and the ATO is attributing a commercially realistic value to the phone so that the correct amount of tax is paid;
- the development of digital cameras which enable the capture, storage and manipulation of images may to some extent replace conventional photographs on which sales tax is currently payable at a rate of 22 per cent. The image captured as digitised information by a digital camera is not subject to sales tax because no new goods have come into existence;
- software is often sold on discs (for example, on hard-drive or separate disc) with goods that are taxable (for example, a laptop computer). As the sales tax law exempts the value of software on discs, taxpayers and the ATO have to ascertain the value of both the software and hardware of the computer so that liability can be correctly calculated; and
- as illustrated in Appendix 2, an absence of traditional wholesalers in a marketing chain may complicate the establishment of taxable value. Goods are now more frequently distributed via chains which lack a traditional wholesaler. Direct marketing and vertical integration of distribution chains (requiring provisions that address arm's length transactions) may blur the taxing point and complicate the establishment of a taxable value (for the purposes of calculating a liability).

2.27 Withholding and Indirect Taxes (WHT) is the ATO business line responsible for administering sales tax.¹¹ WHT's risk management process acknowledges the complexity of applying sales tax law, specifically noting that:

Voluntary compliance with a complex WST [Wholesale Sales Tax] system is in large part dependent on the ATO's ability to clearly articulate taxpayers' obligations under the law.

2.28 Consequently, WHT commits a significant proportion of its sales tax resources to clarifying sales tax law, with over one-third of sales tax staff resources committed to interpretation of the law and providing technical advice. The results of our review of WHT's sales tax law interpretation/clarification and education activities are reported in Chapters 2 and 4 respectively.

Transaction based tax

2.29 A prominent characteristic of sales tax which has a marked effect on taxpayers and therefore on tax administration, is its transactional nature. Sales tax is said to be a transactions based tax because a sales tax liability arises as a result of a dealing with goods, for example, a sale or a lease.

2.30 As it is transaction based, any sales tax advantage over a competitor (by receiving a favourable ATO ruling or by fraudulent underpayment of sales tax) is usually immediately apparent in the price of the goods. In markets where industry cost structures are generally understood, competitors may attribute any unexplained price reduction to a reduction in sales tax and therefore explore avenues to redress the perceived disadvantage. Their three primary avenues of redress are:

- approach the ATO to seek a similarly favourable ruling;
- approach the ATO and advise them of a competitor's possibly fraudulent activities ('dob-in'); or
- undertake similar fraudulent activities.

2.31 If the first two courses of action are ineffective, the taxpayer may consider engaging in fraudulent activity to maintain their market share. This temptation is greater if the taxpayer suspects, or is aware of, tax evasion activities and these activities continue to go undetected/untreated by the ATO (even after a 'dob-in'). Therefore, the risk to revenue is not limited to the revenue lost from one taxpayer as a result of poor advice to the taxpayer or failure to stop fraud by that taxpayer. In competitive markets, a perception by taxpayers that they

¹¹ The ATO's business and service line structure is outlined in Appendix 3.

are receiving less favourable treatment than a competitor is likely to reduce their commitment to comply and potentially further undermine the revenue base. It is therefore important for the ATO to ensure that it provides accurate, consistent and timely advice (see Chapter 2) and that clients perceive the ATO as acting effectively against fraud and other non-compliance (see Chapter 6).

External influences

Taxation industry

- 2.32** As a result of the growing complexity of the application of sales tax law there has been significant growth in the sales tax consulting industry in recent years. Accounting and specialist consulting firms in Australia have recognised sales tax law as a significant source of tax consulting fee income. The industry is reasonably aggressive in identifying potential clients, with a number of firms marketing their services on the ability to derive a tax benefit for a client, from which they take a commission.
- 2.33** These firms are often staffed by former ATO sales tax specialists and this has led to a steady but significant loss of many of WHT's most skilled officers. WHT has recognised that the loss of skilled tax officers poses a risk to revenue and has initiated a program aimed at addressing this deterioration in core skills. Chapter 7 discusses WHT's training program as it relates to its sales tax activities.

Cost of compliance

- 2.34** One of the ATO's major challenges is to reduce the community's cost of complying with sales tax laws. Cost of compliance is an issue that receives significant Parliamentary and community attention.
- 2.35** The ANAO noted that although the Commissioner of Taxation cannot specify the exact nature of records to be kept by taxpayers,¹² some discretion exists regarding information the ATO requires for administration purposes.¹³ In designing administrative arrangements (such as periodic returns, registration applications and refunds claims), the Commissioner needs to balance information sought for compliance management through these arrangements with their effect on the community. The ATO's performance in this regard is reported both in Chapter 3 (Client and Market Research) and Chapter 5 (Administrative Arrangements).

¹² Section 127 of the STAA stipulates that taxpayers and refund claimants must keep records that record and explain all transactions relevant to their assessable dealings and/or credit claims for at least five years.

¹³ Section 113 of the STAA gives the Commissioner the power to prescribe the form and content of the information the ATO requires.

ATO internal management

- 2.36** The ATO is responsible for collecting several different taxes in addition to sales tax, as well as other administrative responsibilities including the Child Support Agency and Superannuation responsibilities. A business and service line organisational structure has been adopted by the ATO to manage these diverse responsibilities. This structure is described in Appendix 3.
- 2.37** In addition to sales tax, the WHT business line is responsible for administering the Pay As You Earn (PAYE) system, the Prescribed Payments System (PPS) and several smaller taxes.¹⁴ We noted that WHT had structured itself around segments of the taxpayer population. For instance, one segment is responsible for managing the tax obligations of clients who have large annual PAYE, PPS and sales tax liabilities. The segmentation approach to compliance management is discussed in Chapter 3 as part of our analysis of WHT's market research program. That chapter also refers to the ATO's risk management decision-making framework which guides the allocation of resources between the various ATO-administered taxes.

Sales tax resources

- 2.38** The ANAO found that WHT had not collected separate staff resource statistics to determine the costs of administering each of the taxes for which it is responsible. In June 1997, with the cooperation of the ATO, we surveyed WHT team leaders in the 25 Branch offices and National Office to seek information regarding the resources associated with sales tax. This involved obtaining estimates of the:
- amount of time team members spent on sales tax related activities (by grade of officer to estimate the salary cost of sales tax) for a pre-defined period; and
 - percentage of this time spent on sales tax by nature of activity (e.g. tax technical work, education, etc.)
- 2.39** The ANAO also sought estimates of management time that could not be allocated directly to sales tax, PAYE, PPS or another tax, so that a proportion could be allocated to sales tax.

¹⁴ Smaller taxes include Interest Royalty Withholding (IRW) and Wool Tax.

- 2.40** The survey response rate was extremely high and covered over 90 per cent of WHT staff targeted by the survey.¹⁵
- 2.41** At 30 June 1997 WHT staff numbered 2605. Although WHT teams are not structured along revenue lines, the survey results indicated that the resources expended on sales tax administration was equivalent to 710 full time staff. Based on the survey results and reported ATO 1996–97 expenditure, we estimate the total cost to the ATO of administering sales tax (including overhead costs) for 1996–97 was approximately \$64m. The ACS estimates the cost to them of administering sales tax on imports in 1996–97 was approximately \$8 million.
- 2.42** As indicated earlier in this report, the survey of WHT revealed that that over one-third of sales tax staff resources are committed to interpreting sales tax law and providing sales tax technical advice. Figure 1 illustrates the breakdown of reported sales tax activity into various compliance and administrative activities.
- 2.43** The significant proportion of time spent on preparing and providing sales tax technical advice is a direct result of the complexity of applying the legislation and the ATO's responsibility to ensure that the application of sales tax law is clear to both its staff and the community (as outlined earlier in this chapter). The management of the sales tax technical program is discussed further in Chapter 2.
- 2.44** Figure 1 also illustrates that approximately one-third of sales tax resources are associated with the management of administrative arrangements (aspects of administrative arrangements are addressed in Chapter 5).¹⁶ Chapter 6 reviews WHT's enforcement program, which absorbs 17 per cent of WHT's sales tax resources.

¹⁵ The survey asked for total staff numbers in WHT teams (other than IRW and Wool Tax teams) as well as an estimate of the time they spent on sales tax activities. This enabled the ANAO to ascertain the coverage of the survey with reference to recorded WHT staff numbers.

¹⁶ This is based on a summation of the following activity groupings illustrated in Figure 1: processing registrations; processing refunds; and other account maintenance.

Figure 1:
Percentage of sales tax resources devoted to each type of administrative activity

3.

This chapter outlines the ANAO's assessment of WHT's compliance activities in relation to interpreting and communicating sales tax law to taxpayers. We noted that WHT has undertaken a number of key initiatives in this area. However, we recommend that a nationally coordinated sales tax technical quality assurance program be introduced for technical advice.

Background

- 3.1 Chapter 1 illustrated the complexity of the sales tax law and how it requires constant interpretation and clarification due to evolving markets, new products, changing technology and aggressive tax minimisation practices by industry. For WHT to effectively administer sales tax, it has first to interpret the law as it applies to the community so that it can then plan its compliance activities.
- 3.2 When a taxpayer asks the ATO for advice on the application of sales tax law, WHT staff must consider the meaning of the law and how it applies to that taxpayer before providing advice. Interpretation of sales tax law is the cornerstone of sales tax administration because without a clear understanding of the law it is impossible to fully appreciate its effects on the community and from that to identify compliance issues. Development and implementation of appropriate compliance strategies can then be undertaken.
- 3.3 In recent years the ATO has been under pressure from various stakeholders, including industry, the Commonwealth Ombudsman and various professional bodies, to improve the consistency, accuracy and timeliness of its technical advice. In 1995 the ATO conducted a survey of sales tax practitioners to seek their views on sales tax technical correspondence. The responses (set out in Table 2 below) indicated that practitioners wanted the ATO to issue more public rulings and highlighted the need for WHT to address deficiencies in the management of sales tax private rulings.¹⁷

¹⁷ Section 77 of the STAA provides that a private ruling is any written ruling, decision, advice or assessment given by the Commissioner to a particular taxpayer.

Table 2:
1995 survey of sales tax practitioners - results regarding opinions of private sales tax rulings

Aspect	What aspects of private rulings are important to practitioners?	How did the private rulings received in the year ended 30 June 1995 rate?		
		<u>Satisfied</u>	<u>Dissatisfied</u>	<u>Neither</u>
Accuracy	96%	40%	32%	28%
Reasons given	78%	32%	40%	28%
Timeliness	74%	36%	44%	20%
Clarity	66%	32%	26%	42%
Consistency	56%	26%	22%	52%

3.4 The survey results suggest that in 1995 the ATO was not delivering sales tax technical advice of a quality satisfactory to these key stakeholders. In July 1996 the Commissioner stated that the community expects the ATO to be experts in the application of the tax laws, inconsistent advice is untenable and there must be only 'one ATO view'.

3.5 In light of this research and the Commissioner's directions, WHT introduced a number of initiatives over the past eighteen months aimed at improving the consistency, accuracy and timeliness of sales tax technical advice emanating from the ATO. In addition, WHT has focussed on improving how it presents advice to taxpayers, so that taxpayers are clear about their sales tax obligations. Hence, the ANAO reviewed WHT's internal processes for forming a position on sales tax technical issues and its approach to communicating technical advice to affected parties.

Forming an ATO position

3.6 The ATO provides oral and written advice (private and public rulings) to taxpayers. When providing technical advice in response to a taxpayer's request or an identified new issue, the ATO has to:

- identify the relevant facts of the case from information provided by the taxpayer;
- establish the issue(s) requiring clarification;

- examine the views, if any, expressed by the taxpayer on how the law should be applied;
- research the relevant law and check whether the ATO has an established view on the issue raised by the taxpayer (where there is no established position, it has to form a position); and
- effectively communicate its interpretation to the affected/interested party or parties.

3.7 Results of the ANAO survey indicated that there were approximately 200 teams spread across 25 ATO branch offices and National Office around Australia preparing and/or providing technical advice (on PAYE, PPS and sales tax issues) for taxpayers and the community as part of their duties. In particular, the equivalent of 230 staff (or 36 per cent of the staff resources involved in sales tax administration) were applied to sales tax technical interpretative work. The sales tax technical skill level required and technical demands on each of these teams vary considerably. WHT therefore has a formidable task in ensuring that the rulings produced are consistent and of acceptable quality.

3.8 As outlined in Appendix 4, teams responsible for preparing sales tax rulings are structured around market segments (with Large client teams, Small/Medium Established [SME] client teams and New client teams). These teams also are responsible for PAYE and PPS administrative functions in addition to sales tax. Analysis of the above survey results also indicated that 48 per cent of time spent performing sales tax duties in large teams involved providing sales tax technical advice, in comparison to 34 per cent for other teams. This lower percentage for other teams appears to reflect greater routine processing and collection demands given that they manage a significantly larger number of clients per staff member.¹⁸ WHT did not collate statistics on technical correspondence by client team although, as discussed below, it is implementing a business system aimed at capturing this data.

3.9 Tax officers advised that, with large corporate clients, the predominant risk to the revenue base is legal challenges regarding the limits of the law. These taxpayers generally employ specialist private advice in an attempt to minimise liability. In contrast, smaller clients, who are more numerous and do not have the same resources as large corporations, are more dependent on the ATO for advice.

¹⁸ Large teams have been allocated a higher staff ratio per taxpayer based on the significantly larger amount of revenue per client. As a result, non-large teams who have a significantly larger number of clients per officer, spend a higher proportion of their time monitoring accounts and undertaking routine processing activities.

- 3.10** The more complex nature of issues arising from dealings with large corporate taxpayers, and the large amounts of revenue at risk, have resulted in many of the most skilled and knowledgeable sales tax officers being placed in Large Client teams. As a result, only a relatively small number of similarly qualified officers remain in the Small/Medium Established (SME) client teams.
- 3.11** The variability of sales tax technical expertise in teams throughout Australia, the complexity of sales tax issues and the volume of technical advice provided, result in a potentially high risk that inconsistent and/or poor quality technical advice will be provided. In addition to sales tax skilling modules (discussed in Chapter 7), WHT has introduced a number of support mechanisms for team members, aimed at addressing this risk. As discussed below, these support mechanisms can be classified as supporting technical specialists, business system support and the supporting framework.

Support staff

- 3.12** The ANAO noted that WHT formed four Regional Technical Support Teams¹⁹ (RTSTs) to assist those tax officers whose duties are to clarify sales tax technical matters in the SME and New segment teams. Assistance takes the form of mentoring, training, providing advice on more difficult issues and monitoring the quality of advice being issued. RTSTs lead, or participate in, branch and regional technical discussion groups and monitor developments in the law or interpretation that may be of relevance to officers in their region.
- 3.13** Where required, RTST officers liaise with large teams that specialise in particular industries or issues and are referred to as Centres for Technical Excellence (CTEs). For instance, the Moonee Ponds large team is a CTE for the motor vehicle industry and may be contacted by RTST officers who seek input on technical tax issues in that industry.
- 3.14** The introduction of RTSTs and CTEs (large teams) is a positive step towards improving the quality of technical advice issued to taxpayers.

Business system support

- 3.15** Business systems can provide substantial efficiency gains. As outlined above, when forming an ATO position, an officer may have to search through a large volume of rulings, correspondence and tax technical papers in addition to the law itself. The officer then has to consult his or her team leader and often other

¹⁹ The ATO is divided into four regions: Northern (Queensland); Southern (Victoria and Tasmania); Eastern (New South Wales and the Australian Capital Territory); and WASA (Western Australia, South Australia and the Northern Territory). Although the RTST for each region is based at a particular branch office, RTST officers are out-posted at all branches within its region.

colleagues (not necessarily located in the same office) before finally having to structure technical advice consistent with ATO standards.

- 3.16** The ANAO found that WHT had either introduced or was implementing business systems to support tax officers to undertake these three aspects of preparing technical advice. Specifically, in recent years WHT has introduced a sales tax technical database and, at the time of the audit, was implementing the ATO Case Reporting System and a communication and research support business system in its tax technical areas (including sales tax).

Technical database

- 3.17** In mid-1995 WHT made available on the TAXLAN a sales tax technical database using ISYS software.²⁰ The database contains all relevant legislation, explanatory memoranda, rulings, bulletins, sales tax determinations, court cases, minutes of technical meetings and technical discussion papers from all regions. Tax officers advised the ANAO that, when using the database, they sometimes found it difficult to distinguish official ATO policy on the meaning of the law from the opinions of individual sales tax officers. Use of the database by less experienced officers poses a risk that advice could be based on material that is not ATO policy, thus undermining the quality of advice provided. WHT was developing a policy to address this risk while the audit was being conducted. The aim of this policy was to stipulate the type of tax technical material to be included in the database (including categorisation based on whether it can be relied upon as ATO policy).

- 3.18** At the time of the audit, the ATO was implementing the Tax Technical Research Facility (TTRF). This system is designed to replace the existing income tax technical research facility, the Tax Technical Database, with a general technical research facility for ATO-administered taxes. At the time of the audit WHT was considering TTRF as an alternative to the existing sales tax database. If adopted, WHT is likely to transfer the material on the current ISYS database to TTRF and retain the database policy currently under development.

Communication and research support

- 3.19** As discussed above, those tax officers whose duties include drafting technical advice are in numerous locations Australia-wide. This has resulted in the need to develop and maintain an effective communication system across the organisation to ensure, among other things, that the interpretation of legislation and subsequent advice to taxpayers is consistent, accurate and timely. In

²⁰ TAXLAN is the Australia-wide ATO computer network. ISYS is a text retrieval package that allows users to search for words and phrases or a combination of words and phrases.

1995, the ATO introduced Grapevine, a computer application that has two functions:

- a message/communication function allowing tax technical staff across the country to contact relevant officers and discuss technical issues; and
- a database comprising these messages/communications and tax technical material.

3.20 As Grapevine is designed to store all messages and comments created using the message function and to enable items of tax technical interest to be placed on the system, it is potentially an additional source of information to the sales tax technical database. The ANAO endorses the approach of using technology to assist communication in a large decentralised technical program.

Case Reporting System

3.21 The Commissioner noted in July 1996 that the ATO had an immediate need to improve the accuracy and consistency of interpretative advice. Among other things, this decision resulted in the ATO expediting its implementation of a Case Reporting System (CRS) for tax technical work in the ATO.

3.22 Primarily, CRS is a computer based technical correspondence preparation tool designed to assist ATO officers to produce technical work of higher quality. It does this by building in a disciplined approach to the analysis of issues and precedents (via Grapevine) to ensure accuracy and consistency. CRS also encourages more structured, logical and complete explanations of the rulings issued in response to taxpayers' requests. In addition, CRS is designed to capture relevant information from completed technical material for inclusion into Grapevine.

3.23 During 1997, WHT began introducing CRS into those areas responsible for preparing sales tax advice (these areas are also responsible for the preparation of PAYE and PPS advice). The ANAO did not review CRS in detail (including its effect on sales tax technical work) as implementation of the system was under way at the time of the audit. However, we acknowledge the benefits to the quality of sales tax technical advice (including cost-effectiveness of delivery) that may result from the implementation of CRS.

Case management

3.24 As the community expects timely responses to sales tax technical enquiries (see Table 2), one of WHT's primary objectives is to issue rulings in a timely manner. This is reflected in WHT's performance standards that require 75 per cent of technical correspondence to be answered within 28 days and 100 per cent within 60 days. We found that in 1996–97:

- the SME and New segments achieved a rate of 89 per cent within 28 days and 98 per cent within 60 days; and
- the Large segment provided 79 per cent of rulings within 28 days.²¹

3.25 WHT acknowledged, however, that not all correspondence was recorded as branches were operating on a variety of locally developed manual or computerised case monitoring systems to both manage and monitor their caseload.

3.26 During the audit WHT commenced implementation of the computer based Case Management, Reporting and Analysis (CaMRA) tool. The principal aim of this tool was to improve the accuracy and capacity of WHT to monitor and manage workloads. We suggest that WHT conducts an evaluation of the effectiveness of CaMRA twelve months after it has been fully implemented.

The supporting framework

3.27 A tax officer responding to an enquiry may find that, after searching the sales tax technical database and consulting colleagues (such as a local RTST officer or Grapevine) the ATO position is still unclear. Similarly, the officer may find the official position is clear, but the facts and circumstances of the case suggest there may be significant revenue implications associated with the advice. Moreover, the officer may sometimes determine that there are compelling reasons supporting a change to the ATO's current interpretation of the law. To ensure that these and other high risk technical decisions are correct before being communicated to the taxpayers concerned, WHT also introduced a formal tax escalation process.

3.28 The ANAO found that the process involves the escalation of identified sales tax technical issues for consideration by regional forums and, in some instances, by national forums of technical experts. Progression to higher levels is according to criteria designed to identify important or high risk issues and ensure their proper consideration by officers at the most appropriate level. WHT's criteria for referral of an issue beyond the team in which it arose include:

²¹ Figures regarding the number of rulings provided in 60 days were not available for the Large segment. The figure for 28 days includes technical correspondence on PAYE and PPS matters.

- there is no established or settled ATO view or precedent;
- established taxation policy or guidelines on the matter are subject to constant challenge or complaint;
- new products or processes are involved which are clearly outside existing precedent;
- inconsistent advice has previously been issued by the ATO;
- there is community or industry-wide application;
- there are substantial revenue implications;
- there is a loophole, deficiency or anomaly in the law or an unintended application of the law that needs legislative correction;
- general anti-avoidance provisions are involved; or
- the issue is likely to have significant impact on the ATO's administration.

3.29 In more difficult or important cases (particularly those with widespread effects on taxpayers) the escalation process will progress to consideration at branch, regional or national level, possibly with assistance from the ATO's Tax Counsel Network.²² This often involves the ongoing drafting of complex and sometimes lengthy technical discussion papers as a basis for analysis and discussion (involving several senior technical specialists and forums) before a position is finalised. The outcome may be a private ruling, public ruling, sales tax determination or bulletin (bulletins are discussed in Chapter 4).

3.30 Diagram 3 below illustrates the three features of WHT's integrated approach to managing sales tax technical advice. These are support staff, business systems support and the escalation process.

²² The Tax Counsel Network consists of senior tax technical experts who draft and provide advice on complex tax technical matters.

Diagram 3:

Key features of the ATO's integrated approach to managing sales tax technical advice

- 3.31** It was observed during the audit that tax officers' understanding of what was to be escalated varied. We found that WHT had been refining the escalation process and supporting documentation during 1997 and, as a result, the documentation may not have been distributed to all relevant parties. We suggest that WHT completes the escalation guidelines and ensures they are accessible in an appropriate format (either as paper copy or integrated into CRS) to all officers in WHT who deal with the public on technical matters.
- 3.32** The ANAO considers that the integrated approach described above has the potential to significantly improve the quality of sales tax technical advice emanating from the ATO. To ensure that the integrated approach is operating efficiently and effectively and that the quality of technical advice has improved, we consider that there would be benefit in WHT periodically assuring itself that the system is operating as intended. For instance, the system is currently limited in its capacity to detect a failure by a less experienced officer to escalate a high risk technical issue.

- 3.33** We found that several branch offices had implemented varying approaches to quality assurance,²³ particularly with regard to correspondence generated by less experienced officers. For instance, a review conducted in one branch office earlier this year found that:
- in some instances, staff were handling correspondence above the level appropriate to their experience;
 - in some cases staff failed to include full reasoning consistent with ATO (and thus WHT) policy in their responses to taxpayers; and
 - CRS templates²⁴ were not being used by all staff.
- 3.34** In addition, we found one office where junior staff were issuing rulings to taxpayers over the public inquiry counter. It appeared that these staff had been briefed to not rule immediately on requests that they perceived to be difficult. However, there was no formal mechanism in place to ensure that these rulings were of appropriate quality or that the issues involved had been considered by specialist officers or forums where appropriate.
- 3.35** The ANAO acknowledges that these issues are likely to be resolved as implementation progresses and fine-tuning of the system takes effect. Further, the risk of sub-standard advice being issued is more likely to exist with SME and New teams, as the Large teams, which manage the bulk of the sales tax revenue, are staffed with tax officers who are more experienced in preparing and providing sales tax technical advice.
- 3.36** However, a nationally coordinated approach to quality assurance would benefit the implementation and ongoing management of the integrated system (especially the management of advice issued by SME and New teams). It would provide valuable feedback to help identify opportunities for improvement. The introduction of the business systems mentioned above in the tax technical area, combined with RTST officers currently located in most offices, provides an opportunity to design a cost-effective national quality assurance program.

²³ Quality assurance in this context refers to the review of a sample of advice that has been issued from the office against pre-defined standards to identify sub-standard practices and their causes, enabling corrective action to be taken.

²⁴ CRS templates have been provided to assist staff with structuring private rulings. These templates include fields (such as reasons for the decision) which must be completed by staff when providing written technical advice.

Recommendation No.1

- 3.37** The ANAO *recommends* that WHT develop and implement a nationally coordinated sales tax technical quality assurance program. The program should take advantage of the efficiencies associated with business system automation of case selection for quality assurance and the existing RTST network for review.

ATO Response

- 3.38** The ATO agrees with this recommendation. As the report acknowledges, in recent years we have concentrated on further developing procedural frameworks and other systems to support our technical decision making. In our view these measures are the best form of quality assurance. To date, in line with our administrative arrangements, QA processes of the kind suggested by this recommendation have been developed and undertaken on a regional basis by the Regional Technical Support teams and on an individual team basis by the Large Business Teams. We accept that there are advantages in adopting a national focus for this activity and we would propose to implement this recommendation by introducing a national approach flexible enough to take account of regional differences. For the Small and Micro segments this would be undertaken by our Law and Interpretation area with significant input from each segment. The Large Business segment would continue to undertake its own QA activities which already have a national focus.

Communicating the ATO's opinion to taxpayers

- 3.39** The ATO uses several avenues for communicating its formal opinion (sometimes referred to as position) to taxpayers. These range from oral advice, written private rulings, determinations and public rulings through to industry agreements. In addition, WHT has a litigation program primarily aimed at clarifying unclear aspects of the law (discussed at the end of this chapter). WHT also produces a variety of public education documents, such as bulletins which, while technically correct, are less specific and presented in a way in which people who are not lawyers or accountants will find more accessible. These education products are discussed in Chapter 4.

Oral advice

- 3.40** The ATO orally answers a significant number of telephone and over-the-counter enquiries. For example, in 1996–97 the ATO received over one million phone enquiries with regard to PAYE, PPS and sales tax. Currently, WHT does not split this figure into those revenue lines but anecdotal evidence

suggests that a significant proportion of enquiries relate to sales tax. Inquiry figures for 1993-94 (when the ATO last reported these figures separately) shows that there were over 400 000 sales tax enquiries.

- 3.41** As noted above, Large teams manage the bulk of sales tax revenue. However, as with written material, a large proportion of sales tax oral advice is provided by junior or less experienced staff. These staff, via their support network and team leaders, are advised to refer more technical enquiries to more experienced officers. Responsibility for ensuring that these staff are handling enquiries in an acceptable manner primarily rests with their respective team leaders. However, the ANAO found no evidence of supporting documentation or training that had been specifically directed at ensuring that the key principles which are followed in providing written advice (as guided by CRS) are used in providing oral technical advice. Training is further discussed in Chapter 7.

Written private rulings

- 3.42** Taxpayers may seek written rulings from the ATO to ensure they have certainty on the ATO's view of the sales tax law and can act confidently in planning and carrying on their businesses without the risk of unforeseen liabilities. The ATO also issues advice in written form to ensure precision and certainty when communicating certain matters to taxpayers.
- 3.43** WHT recorded the issue of some 7000 private sales tax technical rulings in 1996–97, in addition to supplying public rulings and other public information. However, the ANAO considers that deficiencies in recording due to industrial action, counter rulings not being included and anecdotal evidence of material issued without being counted, means that the above figure significantly understates the volume of sales tax technical correspondence emanating from the ATO during that year.
- 3.44** Section 77 of the STAA binds the Commissioner to incorrect rulings issued by ATO officers. If a taxpayer underpays tax as a result of an incorrect ruling the tax cannot be recovered (unless the taxpayer misled the Commissioner).²⁵ An undetected incorrect ruling may have serious revenue implications, particularly when applied to high value and/or multiple transactions. The large number of rulings issued each year and the significant revenue implications of some of these rulings pose a potentially high risk to the integrity of the sales tax revenue base.

²⁵ The ATO can correct its mistake by amending the previous ruling. The taxpayer will be obliged to comply from the date of amendment but tax underpaid before that date cannot be recovered retrospectively unless retrospective legislation is passed.

- 3.45** As outlined above, the ATO introduced several initiatives to improve the quality of its rulings. In particular, CRS is aimed at improving the format, structure and content of these rulings. Similarly, the introduction of CaMRA is likely to assist WHT to improve the monitoring of ruling activity.

Public rulings and determinations

- 3.46** Since the introduction of Streamlined Sales Tax in 1993 WHT has put considerable effort into clarifying the complexities of the sales tax legislation through its public rulings program. Six public rulings (up to 50 pages in length), 28 sales tax determinations and 28 sales tax bulletins have been issued. In addition, newsletters and information booklets have been issued. These rulings and determinations seek to clarify several key issues of direct interest to a large number of sales tax payers. The objective of the sales tax ruling program is to help taxpayers meet their sales tax obligations by removing uncertainty and reducing the cost of compliance associated with obtaining expert advice either from the ATO or from private sector specialists.
- 3.47** In identifying and setting priorities in the issues dealt with in rulings and determinations, WHT consulted industry and professional bodies extensively via the National Sales Tax Liaison Committee.²⁶ The ANAO recognises WHT's efforts in recent years with regard to this initiative.

Industry agreements

- 3.48** Section 43 of the STAA gives the Commissioner power to make agreements with taxpayers on taxable values of particular dealings.²⁷ This enables the Commissioner to put in place practical, industry-wide taxable value agreements where complex selling or distribution arrangements would otherwise result in time-consuming taxable value negotiations on a product-by-product basis. Such agreements can significantly reduce compliance costs, contribute to a 'level tax playing field' within a particular market or industry and assist WHT's efforts at ensuring compliance.

3.49

²⁶ For several years, the ATO has operated a National Sales Tax Liaison Committee which is a consultative forum for sales tax administration and policy issues. This Committee comprises representatives from the ATO and key professional bodies.

²⁷ Subsection 43(1) of STAA states that the Commissioner may enter into an agreement with a taxpayer about calculating the taxable values of particular taxable dealings. Subsection 43(2) provides that where these agreements are inconsistent with the Act, the agreement prevails.

3.50 For the past 22 years the ATO has had an informal agreement regarding taxable values with the motor vehicle industry.²⁸ The agreement removed the need for wholesale companies, manufacturers and importers to individually calculate sales tax liabilities by setting the taxable value of goods to a certain percentage of their recommended retail list price. Its aim was to allow considerable administrative simplicity and substantially reduced compliance costs.

3.51 In recent years, WHT recognised the need to review the agreement and formalise it in writing. As well as the age and informality of the agreement, there was concern about inconsistencies and the significant risks attaching to an agreement covering 29 per cent (\$3.7 billion) of the sales tax revenue administered by the ATO, as illustrated by Figure 2.

3.52 Accordingly, WHT, on behalf of the Commissioner, has been renegotiating the agreement with key motor vehicle industry representatives over the past two years. The Australian Government Solicitor (AGS) has been consulted to ensure that the new agreement accords with the law and can be enforced. In September 1997 WHT advised the ANAO that the agreement will be in place shortly. We acknowledge WHT's work over the period in dealing with this significant matter. WHT also advised that agreements have been reached with the record industry, the photographic industry and an agreement in respect of tax advantaged computer programs. We note that these agreements have not been formalised as yet (in consultation with the AGS) and suggest that WHT ensures that these agreements accord with the law and can be enforced.

Strategic litigation

3.53 Taxpayers have the right to challenge the ATO's interpretation of the law. In a number of instances this results in litigation before the courts or the Administrative Appeals Tribunal. WHT manages the cases brought before the courts by establishing Strategic Internal Litigation Committees (SILCs). SILCs are primarily advisory and decision making bodies with regard to cases. We observed that WHT has implemented or is implementing practices and procedures in conjunction with the establishment of SILCs with the aim of improving its management of litigation. For example, National Practice and Procedure Papers define the systems under which review and litigation functions are to operate, including the process for managing cases effectively. We acknowledge WHT's efforts to continue to improve its litigation management.

²⁸ The power to enter into such agreements also existed under the legislation preceding the Streamlined Sales Tax legislation.

Figure 2:
Sales tax collections (1996–97) by industry group

4.

This chapter outlines the ANAO's assessment of WHT's risk management activities with particular emphasis on market research. The audit found that although WHT had made some progress in this area, significant improvement was possible in gathering and analysing information about clients and their markets for risk management purposes.

- 4.1** The sales tax law is subject to continual interpretation and clarification as new commercial practices emerge, market conditions change, new products are launched and the courts hand down judgements on sales tax issues. As a result, WHT has to both reassess how the law applies to the community and identify market segments and clients who have obligations under the law. Effective identification and analysis of the compliance risks associated with these market segments and clients (taxpayers) enables WHT to develop cost-effective compliance strategies for sales tax and allocate resources accordingly.²⁹

Risk management

- 4.2** WHT has to consider other administrative responsibilities when allocating resources to sales tax compliance activities and make decisions accordingly. To improve the effectiveness of such decisions for WHT and other business lines, the ATO introduced a formal ATO-wide risk management³⁰ process during 1994–95 as part of its strategic planning framework. This process is called the Health of the System Assessment (HOTSA) and has been undertaken on an annual basis across all ATO Business and Service Lines since 1994–95.

²⁹ A key factor in compliance management is ensuring that the administrator has interpreted the law so that markets/clients can be analysed for compliance risks. The identification and analysis of markets and the interpretation of the law are closely linked. A failure to adequately clarify the law limits market identification and analysis while the analysis of markets may reveal areas of the law that require interpretation.

³⁰ The Australian/New Zealand Standard 4360, 1995 Risk Management (AS/NZS4360) defines risk management as: *The systematic application of management policies, procedures and practices to the tasks of identifying, analysing, assessing, treating and monitoring risk.*

- 4.3** The ANAO recognises the key contribution that such a risk management process can make to the allocation of resources and overall effectiveness. We recently conducted an audit of risk management in the ATO which noted that:

*The ATO currently undertakes a range of activities designed to maintain or improve compliance levels. In an environment of self-assessment and shrinking resources, it is vital that the ATO determines where its greatest risks lie and establish the most appropriate and cost-effective treatment and controls for these risks. The effective use of risk management principles contributes to the most efficient use of limited resources.*³¹

- 4.4** This audit reviewed the ATO's HOTSA process at the corporate level, commending the organisation for seeking to address its risks at a strategic level through its risk management process. The ANAO also identified several opportunities for improvement.³² These included:

- *enhancing the identification and use of appropriate management information;*
- *improving the consistency and transparency of the risk management process and resulting decisions;*
- *conducting a more comprehensive and better documented risk identification and assessment of risk;*
- *adopting a better coordinated and holistic approach to treating high priority risks;*
- *improving performance information to monitor progress; and*
- *implementing an effective review function for the entire risk management process.*³³

- 4.5** The ANAO suggests that WHT notes these issues as part of its ongoing efforts to improve its risk management processes. In particular, we note that the 1996–97 WHT strategic framework specifically states that a key risk to compliance management for the business line is that its *...market knowledge is poor and this inhibits risk identification*. For instance, insufficient understanding of taxpayer operations, such as bookkeeping practices,

³¹ ANAO, Risk Management, ATO, Audit Report No.37, 1996–97, page 5.

³² The ANAO concurrently undertook an audit designed to complement the wider ATO Risk Management Audit Report (No. 37) that focused in-depth on the actual implementation of risk management in the Small Business Income Business Line, Audit Report No.19, 1997-98.

³³ ATO Risk Management, Audit Report No.37, 1996–97, page xi.

knowledge of sales tax law, product range and dealings, may limit the capacity of WHT to ascertain the risk of non-compliance and therefore to develop effective compliance strategies.

- 4.6** Consequently, this chapter focuses on WHT's approach to overcoming its lack of market knowledge, which it has identified as an impediment to effective risk management. The remaining chapters consider WHT's performance with regard to implementing and monitoring existing compliance initiatives that directly relate to the administration of sales tax.³⁴

Improving market knowledge

- 4.7** The main benefit of improved market knowledge is the ability to detect emerging compliance issues that have the potential to undermine the revenue base and implement cost-effective preventative compliance measures. For instance, in 1996, through fieldwork and approaches from industry groups, WHT became aware of potentially significant sales tax fraud in the computer hardware industry. As a result, WHT began a relatively large number of sales tax audits in that industry and, in consultation with government and industry representatives, has been exploring possible ways of amending the law to dramatically reduce this kind of fraud.
- 4.8** WHT advised that in the 1980s it detected similar fraudulent activities within the video recorder industry and noted similarities between the market characteristics³⁵ of computer hardware today and those for video recorders last decade.
- 4.9** The ANAO agrees that improvements in the understanding of market structures and products in industry sectors will enable WHT to better detect the potential for fraud and non-compliance as well as take cost-effective preventative action before the revenue base is undermined. We consider that, consistent with the systematic nature of risk management, an efficient and effective means of improving WHT's understanding of these issues is by a structured, cost-effective research program.
- 4.10** There is considerable benefit in a systematic approach to improving sales tax market knowledge given the diverse range of taxpayers, the large volumes of qualitative and quantitative information potentially available, and the complexity

³⁴ These chapters review the ATO's performance with regard to addressing identified risks, that is, the implementation of treatments including monitoring and feedback.

³⁵ Examples of market characteristics are the stage in product life-cycle, number of participants, how long participants have been operating, the size of companies involved and retailing strategies.

of the sales tax law. A systematic program will facilitate the efficient and effective identification, collation, and consideration of information (both qualitative and quantitative) to determine major compliance risks for input into the HOTSA process. Within this context, we reviewed WHT's approach for improving its market knowledge.

Information to support market research

- 4.11** The management of information is an integral aspect of a research program. This is particularly so for the ATO, as it currently receives information from a diverse range of activities. For example, it gathers information via its administrative arrangements and ongoing interaction with taxpayers including audit fieldwork and technical inquiries. The ATO also conducts research using techniques such as surveys, structured discussions with groups of taxpayers (focus groups) and consultation with interested parties (who may include sales tax consultants, industry associations and experienced ATO staff).
- 4.12** WHT has acknowledged that each contact with the community can be classified as an opportunity to learn about taxpayers, markets and associated compliance issues. The registration of taxpayers (for PAYE, PPS and/or sales tax purposes) has been identified by WHT as a key learning event. Registration is an opportunity to gather information about taxpayers which can be used to assess associated compliance issues. We found that WHT had begun research on this initiative while taking into consideration the potential for a single-entry point being developed (as recommended by the Small Business Deregulation Task Force Report).³⁶
- 4.13** WHT has yet to consider in detail opportunities for improving its information base through other current taxpayer contact (such as private ruling requests and telephone and written enquiries). These contacts could be used to identify the nature and frequency of client enquiries about sales tax legislation or difficulties clients may have with current administrative arrangements. During the audit, WHT indicated that it would consider the potential for gathering information through these forms of contact with the community as part of its planned review of the registration process. We encourage WHT to undertake this review as soon as possible.
- 4.14** The ANAO considers that a particularly significant opportunity for improvement in information received is through periodic sales tax returns, similar to income tax returns or annual reconciliation statements. We found that while some

³⁶ In November 1996, the Small Business Deregulation Task Force recommended that a single entry point for government be established for information commonly sought from small business. As outlined in the report, a single entry point allows government (the ATO and other departments) to receive information at one point and pass relevant information onto the various agencies as they require it.

taxpayers are currently required to lodge a sales tax payment return on a regular basis, the information provided is limited to the amount of net liability for the period. Because of this limitation WHT is unable to ascertain basic information regarding how the net liability was calculated including which sales tax rates were applied, the value of goods on which tax was paid and how much of the liability was offset by sales tax credits.

4.15 The lack of information about taxpayers has impeded WHT's capacity to monitor sales tax compliance and to target compliance activities. We recognise that in seeking information from the community the ATO and thus WHT must consider the costs of collecting the information and the costs to the community of providing the information. Although we found that the ATO estimates the community's compliance costs resulting from changes in tax law, this research does not delineate costs associated with:

- complying with existing sales tax laws: taxpayers are required to maintain certain records to calculate their net liabilities; and
- providing the ATO with information.

4.16 We consider it likely that the cost to taxpayers of providing limited additional information to the ATO via returns will be minimal, because taxpayers are already required to prepare the information in the course of determining their sales tax liabilities. Further, the information may be readily available from larger taxpayers who use sophisticated business systems to calculate their liability. We found that WHT had not conducted any research into record keeping practices with regard to sales tax and therefore had not ascertained the additional costs that would be incurred by taxpayers to provide information to the ATO via returns. We consider that WHT research into the record keeping practices of taxpayers for income tax purposes may assist research into taxpayer practices for recording sales and sales tax obligations.

Recommendation No.2

4.17 The ANAO *recommends* that WHT conduct research into the record keeping practices of sales tax clients. The aim of this research is to establish the costs to taxpayers of providing additional information to the ATO, such as the basis of determining liability, through sales tax returns.

ATO Response

4.18 The ATO agrees with this recommendation. Cost of compliance research, in some cases sponsored by the ATO, has been undertaken previously and the results seem to vary between surveys. Given that sales tax payers are required to lodge monthly and quarterly, the likely burden to taxpayers that would arise if they were required to provide a larger quantity of information,

and the costs associated with the ATO capturing that information, could be substantial. For these reasons an alternative that might be considered would be the introduction of an annual return or reconciliation, possibly on a targeted basis. For whichever approach is to be pursued there needs to be a clear understanding of the additional burdens involved and the actual benefits that will be obtained so that an appropriate balance between these competing objectives can be achieved. We are already conducting research that will assist in this process.

Market segmentation

- 4.19** The ANAO noted that WHT's primary focus for improving market knowledge has been to restructure its compliance activities into market segments.³⁷ In late 1996, WHT restructured into three client segments, namely Large, Small/Medium Established and New. Through experience, WHT concluded that broad compliance issues and the associated revenue risks differed between broad groups of clients and it therefore needed to consider different cost-effective compliance strategies for these groups. For instance, Large segment clients have access to specialist tax advice and sophisticated business systems, indicating that understanding of the law and record keeping were not necessarily significant issues in that segment compared to smaller businesses.
- 4.20** WHT is currently restructuring its segments by regrouping the New and Small/Medium Established segments into Small and Micro business segments. This decision was based on an analysis which suggested that a large number of clients had minimal liabilities and therefore were likely to require specific cost-effective measures.³⁸ WHT recently advised the ANAO that preliminary analysis of these new segments suggests that they may be easily sub-segmented into distinct industry sectors and that it intends to further sub-segment as it has done in the Large segment.
- 4.21** Table 3 below contains an analysis of sales tax clients (based on amounts of sales tax paid during 1996–97). This table reveals distinct groups of taxpayers and illustrates the concept of segmentation based on annual sales tax liability.

³⁷ As outlined in Chapter 1, WHT also administers PAYE and PPS collection systems. WHT analysed their client base and found that a large proportion of revenue was generated from a relatively small group of taxpayers (Large clients).

³⁸ Appendix 4 outlines the definitions of these segments in the context of WHT's organisational structure.

Table 3:
Sales tax payment profile (1996–97)

Total 1996–97 sales tax liability	Percentage of total clients	Percentage of total revenue contributed
\$0	89.9	0
\$0 - \$25 000	6.9	2
\$25 000 - \$1 000 000	2.9	20
Over \$1 000 000	0.3	78

Note (1): The large proportion of sales tax clients forwarding no payments to the ATO (89.9%) reflects the significant number of businesses and individuals registered for sales tax for the purposes of claiming exemption from sales tax in relation to some or all of their purchases. None of these individuals and businesses are required to remit sales tax to the ATO.

4.22 As part of the market segment approach, WHT teams responsible for compliance management were tasked with improving their knowledge of the market segments assigned to them.³⁹ We found that, overall, these teams had made limited progress in improving their knowledge of markets and the issues affecting compliance. We noted that a significant proportion of team resources were absorbed by routine compliance activities such as account maintenance and that this restricted the amount of resources available for improving market knowledge. WHT considers that the recent re-segmentation into nationally managed segments for non-large teams will make more resources available for improving market knowledge. However, the ANAO concluded that the structure of WHT's market research program has also hampered progress. As discussed below, we reviewed three key aspects of WHT's market research activities:

- guidelines and reference manuals to assist officers to structure and conduct research;
- business systems support for research activity and its coordination; and
- national/regional specialist support to assist and train teams to conduct their research (people support).

³⁹ The ten Large segment teams were assigned industries and issues to explore. SME and New teams in each branch were assigned the responsibility of clients located in their geographical area.

Guidelines

- 4.23** Tax officers have a wealth of quantitative and qualitative information available that is of variable relevance to improving sales tax market knowledge. In addition to ATO databases, there are numerous external sources including academic research, industry associations, desktop marketing systems and other government departments (such as the Department of Industry, Science and Tourism). There are also the views of key industry participants and bodies together with those of experienced tax officers who can assist in improving market knowledge.
- 4.24** To make the best use of the information available, clear guidelines and reference material assist staff with defining the issues requiring clarification (for example, determining the major compliance risks in a particular market segment) as well as conducting research and structuring information to enable valid conclusions to be drawn.
- 4.25** For example, guidelines can assist staff to improve their knowledge of compliance issues in markets by providing the following:
- a broad framework for defining the objective of research, outlining the methodology, documenting the findings and drawing conclusions in terms of identified compliance risks;
 - guidance on various methodologies. This may include inductive research⁴⁰ approaches that assist exploration and identification of compliance issues in a market. For instance, inductive research may assist describing a market in terms of characteristics that are intuitively understood to influence compliance (for example, size of businesses, bookkeeping practices, use of tax advisers, nature of distribution channels and nature of products). Alternatively, deductive research methods can also be used to learn about a specific issue in a market based on an assumption. Traditionally, these are more statistically orientated;⁴¹

⁴⁰ Inductive research techniques are primarily adopted where there is limited knowledge regarding a market. Information is gathered and structured so that underlying patterns and issues may be identified. Qualitative material combined with knowledge and intuition help the identification of significant compliance issues.

⁴¹ Deductive research is more appropriately applied when there is a reasonable understanding of the market and is traditionally aimed at researching specific issues rather than the identification of issues. For instance, after undertaking inductive research, the primary compliance issue may be a risk that chairs are being misclassified. Deductive research involves the generation of a hypotheses regarding the misclassification of chairs and then researching (usually involving statistical sampling) to ascertain whether or not that hypothesis is correct.

- guidance on potential sources of information and methods for gathering information (such as surveys, literature searches, focus groups, in-depth interviews and data extracts from ATO databases);
- an outline of analysis techniques and tools available and internal or external experts who may assist in research;
- guidelines on updating market research reports, particularly including feedback from any compliance activities that resulted from market research; and
- policy on the management of information including collation, storage, maintenance and retrieval of both quantitative and qualitative information.

4.26 The ANAO found limited material available to staff to assist them with market research. In March 1997 WHT issued a draft risk management proforma to a small number of staff for comment but the document provided no guidance on how to gather and analyse market information from within the ATO or from external sources so as to identify risks.

4.27 Similarly, draft sales tax audit training material outlines external sources of information for planning audits and provides some guidance on sources of information for preliminary work on audit activity. However, once again this document was not widely distributed to staff and, in any event, provided limited guidance on the use of information gathered. The ANAO considers that the absence of appropriate guidelines and reference material has impeded WHT's efforts to improve market knowledge and identify compliance issues (through market research) for input into the HOTSA process.

Recommendation No.3

4.28 The ANAO *recommends* that WHT develop and implement cost-effective guidelines and reference material for staff whose duties include market research and risk identification directed at improving compliance.

ATO Response

4.29 The ATO agrees with this recommendation.

Business system support

- 4.30** Business systems can provide substantial benefits to research by assisting the collation and analysis of information and structuring research. The ANAO found that WHT had increased its capacity to extract information from its major databases by using its Tax Data Warehouse. WHT was also:
- improving its use of other database analysis packages;
 - investigating the use of data-mining software;⁴² and
 - developing a number of computer-based packages which enable staff to collate data from ATO business systems and review trends in payment activities of individuals and groups of taxpayers.
- 4.31** We consider that the contribution of these systems to research will be significantly improved by ensuring staff are appropriately trained and provided with relevant guidelines. As a result, analysis undertaken using these tools will be more easily integrated with qualitative material (as discussed above).
- 4.32** Business systems can also make an effective contribution to managing the research program, especially in a decentralised environment. The capacity to review various market research reports and compare methodologies and information would help WHT to identify better practices and minimise duplication.
- 4.33** The ANAO found that WHT had not taken advantage of business systems to store and manage market research. This limited the capacity of staff to compare and make use of research conducted by other officers. The development of database capacity for storing and managing market research reports and key information (qualitative or quantitative), similar to that developed for tax technical work, would benefit researchers considerably, particularly as they are spread throughout Australia.

Recommendation No.4

- 4.34** The ANAO *recommends* that WHT develop and implement a cost-effective database for maintaining market research reports and practices to help identify better practices and promote information sharing.

⁴² Data mining tools use a range of techniques to detect relationships among data contained in large databases.

ATO Response

- 4.35** The ATO agrees with this recommendation. Implementation of systems in line with the thrust of the ANAO recommendation may be resource costly. A feasibility study will be undertaken.
- 4.36** The ANAO also suggests that WHT would benefit from incorporating the register of analysed risks into the proposed database and, where appropriate, linking these to the research that identified the risks. This would improve the access to supporting documentation for managers tasked with allocating resources based on risks and thus improve the transparency and quality of both risk analysis and risk-based management decisions.

People support

- 4.37** Market research requires a range of skills (for example, research, analytical and computing) and the application and knowledge of various market research techniques. Expert advice and assistance will improve the quality of the market research carried out by the large number of WHT teams with market research responsibilities.
- 4.38** We found that during 1996 WHT formed risk analysis units in each region. These units predominantly assisted staff with extracting data from the data warehouse to identify client bases and help with segmentation tasks. However, we also found no evidence that staff were being provided with specialist market research support.
- 4.39** The ANAO considers that WHT's market research program would benefit from improved staff access to internal and external market research specialists. These specialists could help tax officers undertaking research by acting as mentors, while providing training (discussed further in Chapter 7) and advice regarding the interpretation of information and other techniques. In addition, we consider WHT would benefit from assigning specialist responsibility for coordinating the research program.

Recommendation No.5

- 4.40** The ANAO *recommends* that WHT improve its access to internal and external market research specialists to coordinate, train and assist those staff undertaking market research.

ATO Response

- 4.41** The ATO agrees with this recommendation. WHT recognises the specialist nature of such skills and the benefit of drawing upon external expertise.

Conclusion

- 4.42** The ANAO considers that the restructure of WHT into client segments to allow teams to focus on markets with particular characteristics was a positive step towards addressing the identified risk of a lack of market knowledge. However, a significant improvement in this area has been hindered by the absence of supporting guidelines and the availability of specialist teams to assist market analysis. WHT would also benefit from the use of business systems to enable the efficient exchange and identification of better research practices between teams, branches, segments and business lines.

5.

This chapter outlines the ANAO's assessment of WHT's activities in relation to educating taxpayers about their obligations under sales tax law. We noted that WHT had improved the amount, consistency and technical accuracy of sales tax educational products but consider that it would benefit from the development and implementation of a national education strategy.

Introduction

- 5.1** It is evident that clients cannot comply with their obligations unless they are aware of them. The self-assessing nature of sales tax places a clear obligation on the ATO to meet the information requirements of taxpayers. WHT recognises that clients are more likely to comply if they know what their obligations are. Client education is aimed at addressing these needs and therefore has a significant effect on compliance.
- 5.2** The application of sales tax legislation is complex and applies to a diverse cross-section of taxpayers ranging from multi-national companies to individual primary producers. As outlined in Chapter 3, smaller taxpayers do not have the same resources available to engage professional tax advisers and therefore the sales tax educational requirements for different categories of taxpayers vary considerably.
- 5.3** The ANAO reviewed WHT's progress in educating clients about their sales tax obligations, specifically their system for achieving the following:
- identifying clients' sales tax educational needs that can be cost-effectively met with education;
 - developing products which address these needs;
 - employing suitable mechanisms to deliver products to clients; and
 - monitoring and reviewing the success of education strategies.
 -

Identifying clients' educational needs

- 5.4** The challenge for WHT is to identify taxpayers in need of information on sales tax issues and establish whether these information needs can be addressed cost-effectively. The ANAO observed that over the past five years WHT had identified several groups of clients (client 'segments') requiring education.
- 5.5** To coincide with the introduction of the Streamlined Sales Tax legislation in 1993 the ATO identified the need to conduct an education program aimed at improving clients' basic understanding of sales tax. This program involved producing booklets explaining the sales tax system and undertaking a large number of sales tax seminars.⁴³
- 5.6** The ATO then produced a number of sales tax bulletins and checklists aimed at addressing specific sales tax issues for various industry groups. The need for these products was identified by tax officers in various branches and through contact with industry and professional bodies via the National Sales Tax Liaison Committee. However, the prioritisation and development of these products was not centrally coordinated.
- 5.7** WHT subsequently recognised that a range of targeted strategies was necessary to meet clients' information needs. In 1995 WHT established the Inform and Educate National Support Group (I&E) to increase the coordination and effect of WHT's educational activities on compliance. Formation of I&E provided an opportunity to develop a cohesive education strategy for WHT clients and to improve the consistency and accuracy of educational products (which also included PAYE and PPS products).
- 5.8** The ANAO found that when I&E was formed it identified all WHT sales tax education products generated by various branch offices. These products were then reviewed and, where appropriate, updated and standardised. In addition, key client arrangements have been put in place in the Large segment.⁴⁴
- 5.9** However, little progress has been made in developing strategies for improving the targeting of education for SME and New clients. For instance, I&E's plans for the past two years recognised there was no systematic approach to providing clients with the knowledge they needed to comply with their obligations. As a result, previous education activity had been relatively reactive or ad-hoc in nature. Despite recognition over the past two years that a

⁴³ This chapter addresses material with the primary purpose of educating taxpayers (such as bulletins, pamphlets and booklets) but does not address rulings and determinations which were reviewed in Chapter 2 and are primarily provided to clarify the law.

⁴⁴ Clients with large WHT liabilities have been assigned an ATO account manager for all contact with the ATO which involve WHT-administered taxes.

cohesive approach was necessary, this had not been developed at the time of the audit.

- 5.10** We agree that WHT would benefit from a nationally devised and coordinated strategy for identifying, developing and targeting education material based on identified risks. We noted that the capacity to identify groups of taxpayers that would benefit most from education is limited by the effectiveness of market research. In our view, systematic improvements in market research outlined in Chapter 3 will assist WHT to improve its targeting of education.

Recommendation No.6

- 5.11** The ANAO *recommends* that WHT give priority to developing and implementing a national education strategy for identifying, developing, targeting and reviewing sales tax educational products.

ATO Response

- 5.12** The ATO agrees with this recommendation. A major education campaign was conducted in conjunction with the implementation of the revised SST legislation in 1993. Since that time WHT has maintained a range of education strategies targeted at new and intending business entrants as well as industry specific campaigns. WHT has organised its resources around market segments and this is providing a vehicle to draw together each of the process activities, such as the development and delivery of education products, so that the ATO can provide the best assistance to taxpayers in each segment. Each market segment is developing a national strategy for its clients. The ATO is also looking more broadly at how it can combine and harmonise existing products so that they provide comprehensive information taxpayers need about sales tax, income tax, collection systems and superannuation.
- 5.13** The ANAO notes that as WHT is also responsible for PAYE, PPS and several other smaller taxes this strategy is likely to encapsulate the educational issues associated with these taxes.

Developing products

- 5.14** All ATO written materials which attempt to clarify aspects of sales tax law are considered to be 'rulings' under current legislation and are therefore legally binding on the ATO. The dilemma faced by WHT in developing new educational products is providing information which is easy to understand

without compromising technical integrity. The complexity of sales tax legislation adds to this dilemma.

5.15 As discussed above, WHT has a variety of sales tax educational products currently available for clients, including:

- 28 bulletins: these are issue-based or industry-based and are designed to be more user-friendly and less technically oriented than public rulings or sales tax determinations. Although this product was originally targeted at sales tax payers, ATO research conducted in 1995 indicated that 94 per cent of sales tax practitioners refer to bulletins occasionally or frequently;
- four booklets: one general and three industry-based booklets were produced to provide a basic introduction and explanation of sales tax;
- six industry-based checklists: these were developed during the Primary Producer Project (discussed below) as quick reference guides for clients regarding the circumstances in which sales tax registration numbers can be quoted. The effectiveness of checklists was highlighted by controlled testing undertaken during the project. This revealed that the introduction of checklists coincided with a substantial reduction in the number of refund claims; and
- the Sales Tax Return Book and Guide: this provides instructions on how to make payments, claim refunds and request rulings. It includes pre-printed payment forms for each period of the financial year as well as an overview of sales tax obligations.

5.16 WHT invested significant effort to ensure that sales tax educational products provided to clients were consistent and technically accurate by subjecting all products to a rigorous technical clearance process before they were issued. However, we found limited evidence that WHT tested sales tax educational material during development. Product testing helps taxpayers understand sales tax products and ensures that their educational requirements are satisfied. As outlined below, we suggest testing arrangements be incorporated as part of a product planning framework.

5.17 We also noted that WHT was exploring other forms of educational products, including videos, and has continued to provide seminars at the request of interested parties. We consider that improvements in WHT's understanding of markets will assist with improving the content and type of its range of education products (for example, seminars, leaflets or videos) to meet the identified needs of taxpayers.

Delivering products

- 5.18** Ensuring that educational products are made available to clients involves the use of both active and reactive delivery mechanisms. Reactive placement involves making products available to clients on request. Active placement involves sending educational material or information about available material to clients who have not made a specific request.

Reactive delivery mechanisms

- 5.19** We observed that WHT officers whose duties were to answer enquiries were aware of the range of sales tax educational products. They encouraged use of the material and sent the information to taxpayers. Generally, WHT also demonstrated initiative in this area by introducing two new reactive delivery mechanisms which take advantage of emerging technology.
- 5.20** A 'Fax from Tax' was launched in February 1997 and is an automated telephone service which facilitates the transfer of sales tax products via facsimile. At the time of the audit, this service provided clients with 24-hour access to nine sales tax bulletins and six sales tax checklists. Since its introduction, WHT has gradually added to the information available through this service.
- 5.21** Secondly, the ATO had a home page on the World Wide Web to provide educational materials to clients via the Internet. Sales tax products available via the Internet at the time of the audit included a range of bulletins, public rulings and determinations. In addition to the above products, a two page overview of sales tax was provided.

Active delivery mechanisms

- 5.22** WHT uses several active delivery mechanisms to distribute sales tax educational products and to inform clients about their availability, including advertising campaigns, mail-outs, seminars and attendance at industry gatherings (such as expos, field days and meetings).
- 5.23** For instance, WHT includes basic educational material in payment booklets that are mailed to identified sales tax clients annually. Another education project was the Albury branch office's direct mail-out of sales tax exemption checklists which provided clear guidance to primary producers and key retailers on claiming sales tax exemptions. We consider, however, that limited progress with regard to market research, combined with the absence of a national strategy, have hampered WHT's efforts to improve its capacity to target education more actively.

Monitoring and reviewing products

- 5.24** Monitoring and reviewing the cost-effectiveness of products and how they are targeted, with reference to identified information needs, enables the identification of opportunities for improvement.
- 5.25** Inform and Educate's 1996–97 framework recognised that education activities had rarely been evaluated. In this regard we found that the ATO had taken the following action:
- a study was conducted in 1992 to determine the effectiveness of products provided during the Streamlined Sales Tax education campaign;⁴⁵
 - in 1995 it sought the views of sales tax consultants on sales tax bulletins; and
 - it implemented measures to monitor the changes in compliance between 1993 and 1995 resulting from the active distribution of primary producer and retailer checklists in the Albury region.
- 5.26** The above-mentioned monitoring arrangements for checklists included control testing to determine the effects of checklists on compliance levels. In our view, there would be considerable merit in WHT using similar review methodology to determine the compliance effects of other educational products.
- 5.27** The ANAO noted that WHT had undertaken or contributed to a number of seminars which included sales tax educational material. Although WHT indicated that the majority of seminars conducted have been successful, we noted that some branches conducted sales tax-specific seminars where attendance was poor. We suggest that WHT review the benefits and costs associated with convening sales tax-specific seminars to ensure that this activity represents an effective use of resources.
- 5.28** The ANAO considers that the development of a national education strategy, as outlined earlier in this Chapter, which incorporates a monitoring and review strategy, will assist WHT to improve its performance in evaluating sales tax educational materials.

⁴⁵ This sought clients' opinions of educational materials provided during the SST campaign. Due to the legislative changes at that time, however, determining the effect on compliance levels was impractical.

Conclusion

- 5.29** The ANAO noted that WHT increased the number, consistency and technical accuracy of sales tax educational products in recent years. The recent initiatives using automated facsimiles and the Internet also are noteworthy. However, WHT would benefit by giving priority to the development and implementation of a national education strategy.
- 5.30** WHT would also benefit from a strategy incorporating a consistent approach to product development. The introduction of product plans for all sales tax education products would help improve products, for example, by requiring the following:
- a definition of the taxpayers to whom education is targeted, their characteristics and the nature and extent of their knowledge gap. This would guide the development of the form and content of the educational product and how it may best be targeted;
 - an outline of the research on which the above assertion is based;
 - an evaluation of the product and product delivery alternatives, an estimate of associated costs and an assessment of which best meets the educational need;
 - a plan for developing the product in terms of who will be consulted, how it will be tested and the timing of technical clearance; and
 - recommendations for evaluating the effectiveness of the product and any subsequent review.
- 5.31** We suggest that WHT considers the use of a nationally consistent educational product planning framework as part of the proposed national education strategy.

6.

This chapter outlines the ANAO's assessment of the administrative arrangements such as registration, payment and refund processes that WHT has put in place to enable clients to comply with their obligations. The audit found that sales tax administration would benefit from the introduction of consistent vetting procedures and cost-effective quality assurance processes for registrations. It also recommended that WHT reviews registrations to ensure that taxpayers continue to satisfy registration requirements.

6.1 Administrative arrangements ensure that those taxpayers who understand their obligations and choose to comply with the sales tax law can easily meet their obligations. WHT has numerous arrangements in place, including:

- registration arrangements which enable entities to register with the ATO as taxpayers with obligations pursuant to sales tax laws and which also enable the Commissioner to cancel registrations where appropriate;
- refund arrangements which enable taxpayers to have sales tax credits⁴⁶ refunded by the ATO or have credits offset against sales tax liabilities;
- tax payment arrangements; and
- several other arrangements including procedures for advising changes in address and applications for rulings.

6.2 Three key principles that guide the design of these arrangements are:

- they are 'user-friendly' and accessible, minimising the costs of compliance to taxpayers;
- where appropriate, they collect key taxpayer information to support compliance management; and
- they include cost-effective measures to verify claims where appropriate (for example, ensuring that the grounds for registration are valid before providing a registration number).

⁴⁶ The sales tax legislation contains 31 grounds for claiming a credit of sales tax. For example, a refund is permitted where sales tax has been overpaid.

- 6.3** In Chapter 3 the ANAO noted that WHT had begun research into the nature of information that can be cost-effectively obtained at registration to support compliance management. We also recommended that WHT conducts research into the costs of compliance (to the ATO and the community) for taxpayers providing additional information via arrangements, particularly return forms.
- 6.4** Similarly, Chapter 4 also noted that as part of its education strategy, WHT developed a sales tax return book and reference guide that explains to taxpayers how to make payments, claim refunds and request rulings. The book, which includes pre-printed payment forms for each period of the financial year, is designed to improve the user-friendliness and accessibility of sales tax administrative arrangements.
- 6.5** This chapter focuses on aspects of the sales tax registration and refund processes employed by WHT and comments on its approach to payment arrangements.

Registration

- 6.6** The ATO's key administrative arrangement for sales tax is client registration. Sales tax law permits certain businesses, mainly wholesale merchants, manufacturers and primary producers, to register with the ATO and obtain a sales tax number. Registration is not compulsory but without a sales tax number clients cannot buy trading stock, manufacturing equipment and a wide range of business inputs tax free. Although the tax paid on these goods can subsequently be recovered, it can be a complex and expensive process. With such compelling incentives, most taxpayers eligible to register exercise their right to do so.
- 6.7** The ANAO noted there is a potentially high risk of registration being used incorrectly or illegally and sales tax not being paid because of:
- the complexity of the sales tax legislation;
 - the fact that it is not economically feasible for WHT to obtain information about all quotations; and
 - the access of very large numbers of sales tax registrants to tax free acquisition of goods.
- 6.8** Taxpayers who intend to register for sales tax must lodge an application outlining their claims for registration. If approved, confirmation is provided to clients and they are allocated a sales tax registration number. They are asked to supply this number with any payments or refund claims and, as outlined

above, can use the number, where appropriate, to purchase goods free of sales tax.

- 6.9** Table 4 sets out the numbers of sales tax payers registered each year from 1991-92 to 1996-97. It also indicates the total number of sales tax registrations at the end of each financial year.

Table 4:
Sales tax registrations - 1991-92 to 1996-97

Year	Number registered	Number cancelled	Net number registered	Cumulative registrations
Before Jul 1991	89 500	2 100	87 400	87 400
1991-92	10 900	900	10 000	97 400
1992-93	309 300	3 000	306 300	403 700
1993-94	69 200	10 600	58 600	462 300
1994-95	50 000	11 200	38 800	501 100
1995-96	44 300	8 700	35 600	536 700
1996-97	40 800	9 800	31 000	567 700

Note: The high number of registrations in 1992-93 reflects revised registration requirements under the Streamlined Sales Tax legislation, which was introduced on 1 January 1993. As outlined in Table 3 in Chapter 3, a significant proportion of sales tax registrants are not required to remit sales tax to the ATO as they have registered for the purposes of claiming exemption from sales tax in relation to some or all of their purchases. All numbers are rounded to the nearest 100.

- 6.10** Since 1993-94 the ATO has registered an average of approximately 51 000 taxpayers per year. The capacity of registrants to obtain goods free of sales tax with their registration numbers suggests that an effective registration process is critical to ensuring that:

- only those taxpayers qualified for registration are in fact registered; and
- sufficient information regarding the taxpayer is obtained to ascertain the risk of non-compliance associated with that taxpayer.

- 6.11** We noted that WHT's strategic framework for 1996-97 and beyond acknowledged that before that year the registration of clients was treated as a low-level processing task. The framework contained strategies which transform the registration process into a significant lever for influencing compliance, including:

- developing the capacity to determine the credit or compliance risk associated with new clients;

- increasing scrutiny of new clients who are considered to have a high risk of non-compliance; and
- a number of other strategies aimed at reducing compliance costs for taxpayers and improving data quality.

- 6.12** As outlined in Chapter 3, WHT began research into the information collated during registration to support identification of taxpayer compliance risks. However, because minimal progress was made on the other initiatives, registration of sales tax clients remained primarily an administrative process. By May 1997 WHT had identified that its management structure hampered progress on the implementation of these strategies. It therefore restructured its operations to ensure that the senior executive responsible for running these projects also had direct control of resources. Chapter 8 discusses these matters.
- 6.13** The ANAO reviewed the management of existing arrangements to identify additional opportunities for improving the registration process. We noted that the risk of incorrect quotation of registration numbers for exempt circumstances can be reduced by obtaining sufficient information during the registration process to determine whether registration criteria have been met and, where appropriate, check the validity of this information.
- 6.14** The registration application form seeks taxpayer details including their grounds for registration. We found that practices for verifying the claims made in registration applications varied between branches.
- 6.15** Some branches had introduced practices such as asking for more information through questionnaires, checks against external data and visiting applicants to verify the claims made in the form. WHT officers advised that such practices have detected applicants who did not have grounds for registration despite claims made in their applications.
- 6.16** The ANAO was unable to determine the success of such practices as the number of rejected applications was not recorded. Chapter 6 suggests that WHT may benefit from ensuring that such an activity is recorded in its sales tax audit database.
- 6.17** Also, we found that many branches did not have effective quality assurance processes in place for the registration process. We consider that the absence of such a program has limited WHT's capacity to identify inconsistent or deficient registration practices.

Recommendation No.7

- 6.18** The ANAO *recommends* that WHT introduce nationally consistent vetting procedures and a cost-effective quality assurance program for the sales tax registration process.

ATO Response

- 6.19** That ATO agrees with this recommendation. The ATO is currently developing and implementing a set of policies and procedures that will satisfy this recommendation. These will be implemented progressively over the next 4 weeks.

- 6.20** Table 4 also shows that the total number of taxpayers registered for sales tax has steadily grown in recent years, increasing by about 23 per cent from 462 000 in 1993-94 to 568 000 in 1996-97. We consider that there are numerous cases where the grounds on which a taxpayer is registered may have changed after registration. For instance, a small business may register for sales tax purposes when commencing operations and cease business eighteen months later, or may alter the nature of its business. Section 81 requires taxpayers to inform the Commissioner if they no longer satisfy registration requirements.

- 6.21** The ANAO also considers that it is likely that there is a high risk of misuse of sales tax numbers by people no longer registered or not entitled to be registered. This view is based upon the following factors:

- approximately 568 000 clients were registered for sales tax at the end of the 1996-97 financial year, of whom only about 11 per cent actually paid sales tax to the ATO during that year (a large proportion of sales taxpayers are primary producers whose product is exempt from sales tax);
- the widely accepted view by the community that there is a relatively high rate at which businesses cease trading or change activities (especially within two years of commencement);
- the complexity of the sales tax law, particularly in relation to business inputs exemptions; and
- the lack of enforcement activity aimed at checking the validity of exemption claims (enforcement activity is discussed in Chapter 6).

- 6.22**

6.23 The ANAO found that WHT does not have a strategy to verify that taxpayers continue to qualify for sales tax registration. We acknowledge that the revenue at risk for individual taxpayers may be relatively small, but the large number of taxpayers with sales tax numbers who are not paying sales tax suggests that the overall revenue risk may be large enough to warrant attention.

6.24 The ANAO considers that reform of the registration process as outlined above (including a revision of information gathered to assess compliance risks) provides an opportunity to implement cost-effective measures for ensuring that taxpayers who are currently registered still have valid grounds for registration.

6.25 For instance, information obtained at registration may enable WHT to establish the probability of business failure. ATO business systems could then automatically generate a letter to the taxpayer (after a pre-determined interval) seeking an update on the nature of the business activity and whether it still satisfied registration requirements. Alternatively, WHT could cross-match current registrations with other information about the business and determine whether it was still trading.

Recommendation No.8

6.26 The ANAO *recommends* that as part of its research into reforming the registration process, WHT develop the capacity to cost-effectively verify whether taxpayers continue to satisfy registration requirements.

ATO Response

6.27 The ATO agrees with this recommendation. However, identifying a cost effective solution is likely to be very difficult. It is important to note that WST is, and has always been, a self assessing tax. The ATO is endeavouring to improve its risk analysis and risk management and an approach of this kind will probably yield the most cost effective way of dealing with the issue. Any approach involving some form of comprehensive periodical checking would be prohibitively resource intensive. The ATO advises that it has previously identified a number of ways that could be used to focus on registrants that have ceased business. However, our experience has been that this activity is very resource intensive and it is not always possible to divert the resources needed to perform this task from more pressing work requirements. As a start WHT will identify the scope for introducing a verification process as part of reforming the registration processes.

Payments

- 6.28** Advances in technology have allowed more efficient methods of making payments. The methods currently available are:
- Electronic Funds Transfer (EFT);
 - direct debit;
 - Bill-pay through Australia Post;
 - mailing payment to the ATO; and
 - payment in person at an ATO office.
- 6.29** Our report on Tax Debt Collection⁴⁷ noted that the ATO conducted preliminary analysis into other payment options, including credit cards, and recommended that it conducts research to identify additional options. The ATO agreed with this recommendation. As part of our review of sales tax we found that within these current options, WHT has made considerable efforts to reduce its own costs and clients' compliance costs. These initiatives included encouraging large clients to use facilities such as EFT and direct debit, and encouraging SME and New segment clients to use the Australia Post Bill-pay facility.
- 6.30** Sales tax payers are required to remit liabilities on a monthly or quarterly basis, depending on their annual sales tax liability. For 1996–97 the quarterly remittance threshold was \$56 441. All taxpayers who had an annual sales tax liability at or above this amount for the previous year were required by law to remit sales tax on a monthly basis during 1996–97.
- 6.31** The ANAO noted that WHT had developed business system capacity to monitor both monthly and quarterly remitters. This business system is designed to automatically flag those accounts where no payment was received but had been expected (based on previous payment activity or cycle). WHT staff subsequently contacted taxpayers, assigning priority to those monthly remitters whose expected liabilities were larger, to establish whether a payment was due.
- 6.32** The use of business systems to assist monitoring payment activity is a sound approach.

⁴⁷ Tax Debt Collection, Audit Report No.13, 1996–97.

Refunds (credits)

6.33 The sales tax legislation contains 31 grounds for claiming a credit of sales tax. The most common causes of entitlement to a sales tax credit are:

- when sales tax has been overpaid;
- where entitlement to exemption was discovered after tax was paid;
- when tax-paid goods have been sold to a purchaser who claims an exemption;
- to avoid sales tax being paid more than once on goods; and
- where goods are exported before being used in Australia.

6.34 Registered persons can claim sales tax credits in one of two ways:

- as a rebate on a sales tax return: the taxpayer deducts the credit amount from the gross tax payable for the period. The amount paid and reported on the return is the total liability for the period, less any credits. If the amount due is a credit, the tax payer writes 'Nil' as the amount payable on the return (but has no requirement to lodge a nil return) and then deducts the net credit from gross tax payable on a future return; and
- as a refund from the ATO: the taxpayer completes an application for refund and sends this to the ATO for payment.

6.35 Where credits are claimed as a rebate on a sales tax return the ATO receives the net figure only. No information about the amount of credit claimed or offset is included. Chapter 3 recommends that WHT researches the costs to taxpayers of providing additional information in sales tax returns for the purposes of improving WHT's capacity to monitor and conduct research into compliance levels.

6.36 The ANAO found that in 1996–97 the ATO processed refund applications totalling \$374 million. During that period, ATO Internal Audit conducted a review of WHT's administration of sales tax refunds. This review concluded, among other things, that the occurrence and nature of quality assurance processes for refunds varied between branches. We noted that WHT had begun some remedial action and we suggest that WHT ensures the issues raised are fully addressed.

7.

This chapter outlines the ANAO's assessment of WHT's activities aimed at ensuring that taxpayers comply with their sales tax obligations. The audit found that resources dedicated to sales tax enforcement activity had declined significantly during recent years. In addition, improvements to the content and management of audit activity performance information and the introduction of a cost-effective quality assurance program were recommended.

Background

- 7.1** After applying the other compliance strategies (as outlined in earlier chapters) the ATO has to ensure that those taxpayers who still choose not to comply, or do not comply due to ignorance of their obligations, are detected and brought to account.
- 7.2** We observed that the ATO has several methods for ensuring compliance, ranging from full scale audits involving a thorough examination of all aspects of a taxpayer's sales tax affairs,⁴⁸ to more remote or limited contact such as phone calls or letters. With more limited examinations the ATO may, for example, write to a number of taxpayers requesting information about compliance with one or more aspects of the sales tax law and requesting payment of any unpaid amounts. As all these activities are aimed at checking compliance they can generally be referred to as audit activities.
- 7.3** The effective management of these audit activities is integral to tax administration, especially with regard to a self-assessed tax. Currently, the sales tax administrative arrangements (as discussed in Chapters 3 and 5) provide no means for the ATO to ensure that the self-assessed liability of the taxpayer is correct. Activities directed at ensuring compliance give a number of benefits to the ATO, including:
- detection and recovery of unpaid sales tax;
 - strengthening of the community's perception of the effectiveness of the ATO at collecting all taxes (this can act as a visible deterrent and encourage voluntary compliance);

⁴⁸ This often includes lengthy attendance by ATO auditors at the taxpayer's premises.

- enabling the ATO to identify reasons for non-compliance so that it can review its balance of compliance strategies to change future behaviour; and
- identification of sales tax avoidance or minimisation practices which warrant challenge by the ATO or advice to the Government on the potential for erosion of the sales tax base.

7.4 Although other activities such as educational visits to clients can make a contribution to compliance, an effective program of checking taxpayers' claims and records is the only means of verifying the effectiveness of the ATO's compliance strategy and bringing to account non-complying taxpayers.

7.5 The ANAO reviewed WHT's approach to ensuring compliance with sales tax laws, including the extent of sales tax audit activity and factors that influence the effectiveness of an audit program. We also reviewed aspects of WHT's administration of the penalty provisions of the STAA.

Overall activity

7.6 We found that WHT's tool for measuring activity directed at ensuring compliance was the sales tax audit database, the Case Reporting and Management System (CRMS). This system contains information on each audit case, including adjustments resulting from audits and some basic information regarding the source and nature of the audit. Figure 3 illustrates the significant reduction in the number of sales tax audits and the amount returned as reported in CRMS over the past eight years.

7.7 ANAO consultation with professional bodies and a review of submissions on the computer industry project and National Sales Tax Liaison Committee (NSTLC) minutes revealed that sales tax practitioners and the accounting profession have been critical of what they perceive as the ATO's lack of enforcement activity in recent years.

Figure 3:
Sales tax audit activity (from CRMS)

Note : The dollar return for each year includes adjusted assessments, the revenue associated with outstanding returns identified and outstanding debt collected by auditors. These figures are provided as an indicative guide as the ANAO has expressed concern over the reliability of data contained in CRMS (refer discussion commencing at paragraph 6.25 of this chapter).⁴⁹

7.8 CRMS reports indicated that for 1996–97 the ATO conducted 2069 sales tax audits. This represents an audit coverage of 0.4 per cent of the taxpayers registered for sales tax as at 30 June 1997.⁵⁰ Further, we noted that 777 of these audits were conducted on taxpayers classified by the ATO as active

⁴⁹ The ANAO found that there was an error in the CRMS reporting system which more than doubled the audit return for 1992-93. We raised this issue with the CRMS system administrator (the figure reported in Figure 3 for 1992-93 (\$77 million) is the adjusted figure). We noted that CaMRA was replacing CRMS and that the ATO may benefit from regularly testing the accuracy of reports developed in CaMRA.

⁵⁰ As at 30 June 1991 there were 87 400 registered clients (refer Table 1 Chapter 5) with 3529 audits conducted in 1990-91 representing an audit coverage of four per cent. The significant reduction in audit coverage since June 1991 is a result of a dramatic increase in the number of primary producer taxpayers registered for sales tax purposes under the SST legislation in 1993 and a corresponding reduction in audits over the period (it is extremely rare for primary producers to pay sales tax as they are registered to gain access to business inputs exemptions).

payers⁵¹ in 1996–97. This represents 1.3 per cent of the 59 200 active taxpayers that made payments during the year.

- 7.9** In addition, there is a wide variety of organisations and individuals who cannot register but are entitled to claim sales tax exemptions by providing a declaration to the vendor so that they can purchase the goods free of sales tax. The ATO sales tax booklets provide guidance on how to make such declarations. However, the ANAO found that the ATO has not ascertained the extent to which such declarations are used and the associated compliance risks.
- 7.10** The lack of coverage of fieldwork, combined with limited information obtained on exemption declarations and limited information being provided after registration to the ATO, significantly undermines the ATO's capacity to ensure the integrity of the sales tax system.
- 7.11** CRMS also has the capacity to record days spent on audit activity. According to data in the system, the time spent on audits fell 83 per cent over the eight year period specified in Figure 3. Our survey results indicated that 17 per cent of current sales tax resources were used in conducting enforcement activity, representing the equivalent of about 108 staff. WHT advised that the reduction in sales tax audit resources in recent years was a deliberate decision undertaken in conjunction with the introduction of the Streamlined Sales Tax legislation (SST) in 1993. The ATO considered that it was appropriate to put resources into clarifying the sales tax law and educating taxpayers before conducting enforcement activity. Further, WHT internal documentation indicated that as a result of the reduction in audits the ATO has lost a significant amount of its sales tax auditing skill base (refer Chapter 7 for discussion on training issues).
- 7.12** The ANAO acknowledges the benefit of redirecting resources into tax technical and educational areas for a limited time after the introduction of SST. However, we noted that according to CRMS audit resources for sales tax continued to decline in 1996–97. The absence of an effective program for ensuring compliance has the potential to undermine the revenue base. An effective program should be sufficiently resourced and managed to ensure that the community is confident that non-compliers will be detected and brought to account.
- 7.13** We consider that as it is over four years since the introduction of SST there would be considerable benefit in WHT re-evaluating its resource commitment to activities directed at ensuring compliance.

⁵¹ Active payers are those clients who are registered for sales tax purposes and who are expected to incur a sales tax liability on a regular basis.

Recommendation No.9

- 7.14** The ANAO *recommends* that the ATO assess the scope for reallocating resources to the sales tax audit program.

ATO Response

- 7.15** The ATO agrees with this recommendation. The ATO has identified this issue and is dealing with it.
- 7.16** The aim of this exercise is to improve substantially the ATO's capacity to detect and bring to account sales tax properly payable.
- 7.17** In addition to adequate resourcing, there are three key factors that influence the effectiveness of an audit program. These factors are discussed below:
- the sales tax audit management information system;
 - targeting sales tax audit activities; and
 - the quality of sales tax audit activities.

Management information system

- 7.18** Management information is central to managing and monitoring an audit program. For 1996–97 and earlier years CRMS was WHT's source of management information about sales tax audit activity. As discussed below, the ANAO reviewed the:
- capacity of ATO business systems to provide *relevant* information regarding the efficiency and effectiveness of the sales tax audit program; and
 - *reliability* of audit information contained on the sales tax audit database.

Relevance of information

- 7.19** An effective audit management information system provides complete and relevant information regarding activities directed at ensuring compliance. The ANAO found a lack of clarity with regard to what activities were to be recorded in CRMS. For example, we found a team that was conducting visits to taxpayer premises to establish the legitimacy of taxpayers' grounds for registration, but this activity was not captured by CRMS or any other system. Given the

potential future directions of compliance activity for validating taxpayer claims (for example, surveys requesting data and voluntary disclosures), this lack of clarity regarding what should be recorded on CRMS limits WHT's ability to effectively monitor and evaluate these activities.

7.20 During the audit, WHT advised that CRMS was being replaced with CaMRA which will record the majority of compliance activity. The ANAO suggests that WHT reviews CaMRA to establish its capacity to identify all the activities now regarded by the ATO as validating taxpayer claims and ensuring compliance.

7.21 We also found that the information contained on CRMS did not give an accurate picture of the results of the ATO's audit program. For example, the database contained adjustments claimed to be made by auditors as a result of audit activity. However, no CRMS information was available to determine whether these adjustments were attributable to:

- voluntary disclosures due to an impending audit;
- the liability raised as a result of the audit; or
- the amount of revenue actually collected from audit activity (this is not necessarily the same as the liability raised).

7.22 We found that the data contained in CaMRA regarding sales tax audit activities was similar to that of CRMS. As a result, although WHT has developed the new system it will still be unable to ascertain the effects on the revenue of its sales tax audit program.

Recommendation No.10

7.23 The ANAO *recommends* that WHT develop the capacity of its business systems to record and report the effects of the sales tax audit program on liabilities and revenue.

ATO Response

7.24 The ATO agrees with this recommendation and will examine options.

Reliability of information

7.25 The ANAO sampled 26 sales tax client accounts from the ATO Integrated System (AIS)⁵² that matched the sales tax numbers recorded on CRMS for the eleven month period ending 30 May 1997. These sales tax numbers

⁵² AIS contains taxpayers' accounts.

accounted for two-thirds of the adjustments reported in CRMS for the period and approximately one-fifth of the number of audits. We found that a significant proportion of these adjustments could not be traced to sales tax accounts on the AIS.

- 7.26** In this regard, we referred one case to the ATO that accounted for over 20 per cent of audit dollar return for the period. This case was subsequently removed from the 1996–97 audit results recorded in CRMS. Consequently, we have some concerns about the reliability of the amount of adjustments and the number of audits recorded in the database.
- 7.27** We found that there were no clear rules regarding the timing and nature of adjustments and other information to be recorded on CRMS. In addition, there was no periodic checking of the quality of data in the system. We also found no evidence to suggest that WHT is improving its management of sales tax audit data quality with the introduction of CaMRA.

Recommendation No.11

- 7.28** The ANAO *recommends* that WHT develop and implement a data quality policy for the sales tax audit database, including clear business rules for the entry of data and a program for monitoring data quality.

ATO Response

- 7.29** The ATO agrees with this recommendation. A proposal already exists to develop and implement these measures as part of the ongoing enhancements and improvements scheduled to be made to CaMRA.

Targeting audit activities

- 7.30** With limited resources an effective means of targeting audit activity is essential. The ANAO reviewed the source of audits as recorded in CRMS. The majority of audits conducted were the result of compliance projects, internal information or ‘dob-ins’ from the community (individuals informing the ATO of potentially fraudulent activities). The main sales tax audit project in 1996–97 was the computer industry project, with CRMS reporting a 1996–97 return of approximately \$9 million. It also reported that \$12 million was returned following audits that were conducted in 1996–97 as a result of ‘dob-ins’.
- 7.31** The ANAO considers that WHT’s capacity to target compliance projects will improve with development of its market research capability (see Chapter 3).

‘Dob-ins’

7.32 As ‘dob-ins’ are a significant source of ATO intelligence, we reviewed WHT’s approach to managing those relating to sales tax. We found that WHT did not have nationally consistent procedure for handling and recording sales tax ‘dob-ins’. For example, some branch offices did not record them while others had comprehensive registers. As a result, WHT was unable to inform the ANAO of the number of ‘dob-ins’ received. We also observed that branch offices had developed varying local arrangements regarding which officers are responsible for interviewing informants (primarily by phone).

7.33 We consider that WHT would benefit by adopting a national strategy that outlines the:

- skills and experience required of contact officers responsible for interviewing informants;
- information that contact officers should seek from informants;
- feedback that is to be provided to informants with regard to the action the ATO may take (noting that privacy and secrecy issues limit the feedback that contact officers can provide);
- basic criteria for evaluating the information provided and guiding decisions on further action; and
- requirements to record the information provided.

7.34 The ANAO considers that WHT has made some progress in this area by introducing ‘dob-in’ recording facilities in CaMRA. However, the absence of a national policy that addresses issues other than recording limits WHT’s capacity to make effective use of the information provided. We noted that it is a longstanding practice in numerous law enforcement and other government agencies to institute policies and procedures for handling information received from the public.

Recommendation No.12

- 7.35** The ANAO *recommends* that WHT develop a national policy for the management of sales tax ‘dob-ins’ from the community.

ATO Response

- 7.36** The ATO agrees with this recommendation. WHT has planned to do this and it will be achieved through the enhancement of the CaMRA tool.

Quality

- 7.37** The quality of audit activity significantly influences the audit outcome. Poor audit practices may result in the ATO foregoing revenue due to its failure to detect underpayments or evasion. They may also signal to the community a deficiency in tax administration and thus undermine the integrity of the tax system. An integrated quality program involves:

- articulation of audit standards;
- systematic monitoring (quality assurance) aimed at detecting sub-standard audit activity with reference to the standards;
- corrective action where required for individual cases;
- changes to the system (for example, new training and/or revised delegations) to redress recurring sub-standard activity; and
- potential identification of better practices and audit techniques.

- 7.38** Although the ATO has sales tax audit standards, the ANAO found no evidence of a systematic quality assurance program aimed at identifying sub-standard audit practices. Consequently, WHT is not in a position to ascertain the overall quality of its sales tax audit activity and thus systematically identify and correct deficiencies. We consider that WHT would benefit from introducing a quality assurance program for sales tax audit activity. The use of the sales tax database to select a limited number of audits for quality assurance using pre-defined criteria would assist in ensuring such a program is cost-effective.

Recommendation No.13

- 7.39** The ANAO *recommends* that WHT develop and implement a cost-effective sales tax audit quality assurance program. This program should take advantage of the efficiencies associated with case selection via the sales tax database.

ATO Response

- 7.40** The ATO agrees with this recommendation. This capability is currently being developed.

Penalties

- 7.41** An effective penalty regime is an integral part of a self-assessing taxation system such as sales tax. The Sales Tax Assessment Act imposes penalties in a number of circumstances, including where:
- false statements are made to a taxation officer (section 97);
 - late payment is made (subsection 68(1)); and
 - a return or other material is not provided as required (section 96).
- 7.42** Compliant taxpayers can expect that the Commissioner will maintain a 'level tax compliance field' so that non-compliers do not gain an unfair commercial advantage.
- 7.43** The ANAO was advised that section 97 penalties (false statement) are primarily considered for application in the course of audit activity, as an audit is usually required to identify where false statements are made. In this regard we consider that a cost-effective audit quality assurance program will enable WHT to monitor its performance in imposing this penalty.
- 7.44** The ATO's performance with regard to administering the late payment penalty provisions of tax laws it administers, including the STAA, was reviewed as part of our audit of Tax Debt Collection. We concluded that there was a significant risk to the revenue resulting from late payment penalties not being imposed according to legislation. The main contributing factor to this risk was the ATO's business systems' limited capacity to automatically impose the penalty. We also suggested that there was benefit in the ATO reviewing the legislative framework for late payment penalties by simplifying the relevant legislation and reducing the costs of compliance for both the community and the ATO.

- 7.45** The ANAO focussed on WHT's performance in administering section 96 penalties.

Late lodgment penalties

- 7.46** Taxpayers are required to lodge a sales tax return consisting of a payment advice if they have a sales tax liability. In 1996–97 over 60 000 taxpayers lodged at least one payment return with payment. Section 96 imposes a penalty equal to double the tax payable on any goods where a person fails to provide a return or other information as required.

- 7.47** Where there is both late lodgment of a return and late payment of tax, the penalty under section 96 applies in addition to the late payment penalty under subsection 68(1). The Commissioner has power to remit penalties that are imposed by the law. In this regard a sales tax ruling has been issued to clarify the Commissioner's position on the remission of penalties. It states that:

...persons who have simply failed to provide a return or information when required under the law on an isolated occasion will ordinarily have the penalty reduced to an amount equal to 2 per cent of the tax payable unless there are factors that warrant a decrease in that figure. ...

... persons who have repeatedly failed to provide returns or who have failed with a direction to provide returns or information will ordinarily have the penalty reduced to an amount of 10 per cent of the tax payable unless there are factors that warrant an increase in that figure such as:

- *co-operation has not been reasonable and, as a result, there have been undue or excessive delays in the completion of official enquiries; or*
- *deliberate steps have been taken to conceal the need to lodge returns (for example the falsification of records).*

Each factor might warrant an increase of 50 per cent in the penalty ordinarily imposed.

- 7.48** The ANAO found that the ATO business system flags taxpayer accounts as 'detect-non-lodger' where there is an apparent failure to lodge a return. At 30 June 1997 over 50 000 sales taxpayer accounts had these flags. However, a significant proportion may have constituted cases where the taxpayer had no actual liability for the period where a return was expected. In such cases the taxpayer is not liable for late lodgment penalty.

- 7.49**

7.50 The ANAO subsequently reviewed the ATO's debt collection system to obtain an indication of the number of sales tax accounts that were paid late during 1996–97. In these cases it is highly likely that the taxpayers also failed to lodge the corresponding return. Tax officers advised the ANAO that taxpayers with sales tax liabilities they are unable to pay are generally unlikely to volunteer a return unaccompanied by a payment. We found that in 1996–97 over 5700 taxpayers paid their sales tax accounts late and therefore were likely to have lodged late. If so, they would accordingly be subject to both late payment and late lodgment penalties.

7.51 We also found that in 1996–97 less than 50 taxpayers had a late lodgment penalty imposed, totalling some \$600 000.⁵³ Given this relatively insignificant imposition of late lodgment penalties, and in light of the large number of taxpayers that potentially should have attracted the penalty, we consider that there is a significant risk that late lodgment penalties are not being imposed in accordance with section 96 of the STAA and the Commissioner's ruling.

7.52 We reviewed aspects of WHT's approach to administering section 96 and found that the Policy and Procedure manual outlined that the imposition of a sales tax late lodgment penalty was the primary responsibility of debt collection staff. As the ATO business systems do not have the capacity to impose sales tax late lodgment penalties automatically, it is done manually. We consider this to be a time-consuming process and likely to be the key contributing factor to the low incidence of penalties.

7.53 In response to the recommendations of the Small Business Deregulation Task Force and the ANAO's Debt Collection Audit report, at the time of the audit the ATO was reviewing the late lodgment and late payment penalty provisions of tax laws, to improve the practicality and fairness of penalties. Regardless of the outcome of this review, the capacity of the business system to automatically impose late lodgment penalties for sales tax is integral to efficient and effective administration.

Recommendation No.14

7.54 The ANAO *recommends* that, subject to the outcome of the ATO late lodgment and late payment penalty review, the ATO develop the business systems' capacity to automatically impose sales tax late lodgement penalties (section 96).

ATO Response

⁵³ These figures relate to active sales tax clients.

- 7.55** The ATO agrees with this recommendation. The ATO is awaiting the outcome of the review referred to in the recommendation and the matter will be further examined when the review process is completed. Automatic imposition has been considered previously but, given other competing priorities in the area of needed system changes, has not been implemented.

8.

This chapter outlines the ANAO's assessment of WHT's activities to ensure staff have relevant skills. The audit noted that WHT had recently developed a comprehensive sales tax technical training program but concluded that WHT would benefit from full implementation of training in audit techniques.

Introduction

- 8.1** Staff involved in sales tax administration require a sound knowledge of a complex body of legislation and an understanding of its application to various industries. They also require a sound knowledge of the processes necessary to administer the law, such as auditing, risk analysis, client profiling, and drafting of private and public rulings.
- 8.2** The ANAO reviewed WHT's approach to skill development for staff with sales tax duties. Broader aspects of human resource management including the recruitment of staff with particular skills, and performance management, were not considered as part of the audit. We focused on the following three key components of an effective staff training program:
- identifying staff skills requirements;
 - developing and implementing initiatives such as on-the-job training and formal training or the use of mentors - all of which enable staff to develop the required expertise; and
 - monitoring and reviewing the effectiveness of training programs to ensure relevance to changing laws and taxpayer practices, thereby identifying opportunities for improvement.
- 8.3** We found that WHT had made concerted efforts to implement training programs which enabled staff involved with sales tax duties to develop the necessary technical and general administrative skills. At the time of the audit WHT was conducting an evaluation of the effectiveness of the sales tax technical curriculum (discussed further in paragraphs 7.9 and 7.17). This evaluation should provide an indication of the success of this investment in staff skill levels and WHT performance.

Identifying skills requirements

- 8.4** To fulfil their duties efficiently and effectively, WHT staff are required to:
- comprehend complex sales tax laws;
 - understand a wide range of administrative processes (such as refunds, account maintenance and registration) and practices (for example, risk analysis and auditing); and
 - have the skills to apply this knowledge to perform their duties (for example, legal drafting and written communication skills, client service skills, computing and numerical skills, interview skills, problem solving and research skills).
- 8.5** At the time of the audit WHT was developing a comprehensive business skills model which defines the generic skills and attributes its officers should possess. When developed, the model will be used as a benchmark for assessing the developmental needs of staff. However, in the absence of this model, WHT has identified a number of core competencies that staff require to perform their duties.
- 8.6** For instance, the ANAO found that WHT used both the National Sales Tax Liaison Committee and annual sales tax weekend workshops⁵⁴ to identify systemic sales tax administrative problems to be addressed via skill development programs. Concerns about the lack of sales tax technical expertise among ATO staff were raised by sales tax consultants through these forums in 1995. To address these concerns, WHT developed a comprehensive set of sales tax technical training modules for staff (discussed further in paragraph 7.9).
- 8.7** Similarly, during 1995–96 WHT identified the need for a mechanism to determine on a regular basis the skill development requirements of individual staff. WHT subsequently initiated learning plans to address this need and included them as a strategy in the 1996–97 WHT plan. Learning plans for all staff were to be completed by February 1997, however, we found that some teams had not fully implemented the learning plan scheme.

8.8

⁵⁴ Annual workshops have been conducted by the ATO and the University of NSW since 1989. They bring together key ATO sales tax officials, sales tax practitioners, taxpayers and industry and professional bodies.

8.9 Delays in the development of the comprehensive business skills model and the full implementation of individual learning plans have impeded WHT's ability to identify gaps in staff skills. However, we acknowledge that once completed, the above initiatives will enable WHT to effectively identify staff skilling needs.

Developing and implementing skills development programs

Sales tax technical skills

- 8.10** In response to the recognised need to improve sales tax technical skills, twenty skills development modules were developed as part of a sales tax technical curriculum. Further modules are under development. We concluded that the work completed to date on this curriculum is comprehensive and well structured. We also noted that substantial quality control measures were implemented as part of the project to ensure consistency and accuracy.
- 8.11** Interviews conducted during the audit indicated that the participation rates for this program have been reasonably low and concerns were expressed about whether the program had been effectively targeted. The 1997 evaluation of the sales tax curriculum is likely to establish the extent of these concerns.
- 8.12** WHT acknowledged that the complicated nature of sales tax legislation also lends itself to a 'mentor' approach to training. We found that using mentors is the predominant form of imparting sales tax knowledge, with RTST officers (see Chapter 2) and a number of experienced sales tax officers acting as mentors for inexperienced sales tax staff.

General administrative skills

- 8.13** The ATO has several programs designed to address staff administrative skills. The Taxation Officer Development Program (for ASO1 to ASO3 level staff) and the Administrative Services Officer program (for ASO4 to ASO6 level staff) provide training programs which cover general administrative skills including letter and report writing, client contact and presentation skills. Although not specifically designed for sales tax, both programs are aimed at providing a structured approach to the development of general administrative skills.
- 8.14** A discipline requiring a high degree of technical skill is auditing. This was recognised in November 1993 by the Joint Committee of Public Accounts in Report No. 326, *An Assessment of Tax*. The Committee recommended that all ATO audit staff be trained in accounting requirements, standard financial

auditing techniques, methodologies and systems. The ANAO found that a draft sales tax audit training manual was substantially completed in 1994, however, since then it has remained as a draft. As a result, the program has not been fully implemented (an issue highlighted by the WHT 1995–96 Business Plan). We suggest that WHT completes and implements, as soon as possible, a comprehensive audit training program for staff undertaking sales tax audits.

Monitoring and reviewing skills development programs

- 8.15** Continuous monitoring and review of skills development programs is necessary to ensure they are timely, relevant and cost-effective. This monitoring and review includes the collation and analysis of staff participation rates and evaluation of program effectiveness.
- 8.16** Although the ATO currently uses its human resource management system (NOMAD) to collate program participation statistics, it acknowledged during the audit that these statistics do not provide an accurate representation of actual participation rates. Self-paced training packages (which allow participants to work through modules at their own pace when time allows) often are not recorded on NOMAD. Inaccurate participation statistics limit WHT's ability to measure target group participation rates and hamper evaluation activity. The ANAO suggests that WHT investigates cost-effective means of determining more accurate participation statistics for training programs.
- 8.17** A second aspect of the monitoring and review process is determining the effectiveness of current skill development programs. This can be achieved by evaluating current programs, obtaining staff feedback about programs in which they have taken part and investigating the effects that programs have had on staff performance.
- 8.18** WHT advised that due to the concerns raised by stakeholders the majority of its training resources for the past eighteen months have been committed to developing the sales tax technical curriculum. As a result, WHT selected the curriculum as the primary training program to be reviewed this year. As already noted, an evaluation began during the audit which included a survey of participants undertaking the program.

9.

This chapter outlines the ANAO's assessment of WHT's planning, coordinating and monitoring activities. The audit noted that WHT had recently undertaken a comprehensive evaluation of its planning process and that significant efforts had been made to address the recommendations arising from this review. The audit concluded that WHT would benefit from developing key outcome measures and including milestones for the achievement of outcomes in business plans.

- 9.1 As stated in Chapter 1, WHT has over 2500 staff spread throughout Australia responsible for compliance activities associated with PAYE, PPS and other smaller taxes, in addition to sales tax. To ensure that identified initiatives and day-to-day compliance activities are coordinated within WHT and with the rest of the ATO, an effective corporate governance framework is required.⁵⁵
- 9.2 Corporate governance is concerned with structures and processes for decision-making and with controls and behaviour within organisations that support effective accountability for performance outcomes. Effective corporate governance practices include implementing sound business planning and performance evaluation processes.⁵⁶
- 9.3 WHT manages sales tax in conjunction with its other taxation responsibilities. The ANAO therefore considered aspects of WHT's governance framework. In particular, we focussed on WHT's plans, coordination of implementation of these plans and monitoring.

Plans

- 9.4 WHT has undertaken extensive national, regional, segment and branch level planning. We noted that an evaluation of the WHT strategic planning process which focussed on its strategic plans since 1994 was completed in April 1997. The evaluation found that WHT's strength was in strategic design, rather than

⁵⁵ Corporate governance is a concept most commonly used to describe the overall management of the affairs of organisations.

⁵⁶ Australian National Audit Office, *Applying Principles and Practices of Corporate Governance in Budget Funded Agencies*, 1997.

implementation. The evaluation also noted several deficiencies in planning that hampered the management of compliance activities. These included:

- the goals set out in WHT strategic plans for both 1995-96 and 1996-97 were not explicitly linked to the ATO corporate focus areas for this period and the activities of other business lines were not considered;
- overall operational measures (Operational Performance Standards [OPS]) that measure outputs exist (discussed later in this Chapter), but there were no strategic outcome measures; and
- there were no objective indicators of how well accountabilities have been met.

9.5 We found that WHT had made progress towards implementing the recommendations of the April 1997 evaluation in the 1997–98 WHT plan. In particular, the plan included an overview of proposed treatments for identified high risks together with proposed strategies and projects to address key ATO corporate leverage points.⁵⁷

9.6 The ANAO also found that the plan expressed WHT goals and strategies more clearly than in previous business plans and improved its links with ATO corporate goals and strategies. As the plan is used to communicate WHT's goals and strategies to various stakeholders, these improvements are likely to result in greater understanding of WHT's priorities and improve the likelihood of their achievement.

9.7 In earlier chapters we noted that WHT had made limited progress in implementing a number of initiatives set down in earlier plans. For instance, minimal progress was made with the national education strategy (Chapter 4) and reforming the registration process (Chapter 5). As outlined above, the evaluation concluded that plans did not contain objective indicators of how well accountabilities have been met.

9.8 Our review of the 1997–98 WHT plan revealed that individual accountabilities for measures have not been incorporated for all strategies. In addition, milestones (that is, dates by which defined aspects of projects are to be completed) have not been included. This limits the WHT Executive's capacity to objectively assess the extent of progress in implementing strategies and hold individuals clearly accountable.

⁵⁷ The ATO 1997-2000 corporate plan includes eleven key leverage points for improving administration as part of its corporate program.

9.9 WHT has evaluated its planning process resulting in improvements to its 1997–98 strategic plan. However, we consider that further benefits will be realised by:

- ensuring that individual accountabilities are clearly assigned for all proposed measures; and
- incorporating milestones for implementation of specific strategies and/or projects in WHT plans.

Recommendation No.15

9.10 The ANAO *recommends* future WHT planning documentation incorporate individual responsibility for all measures and milestones for the achievement of specific compliance initiatives, where appropriate.

ATO Response

9.11 The ATO agrees with this recommendation. The measures have been adopted in the 1997–98 planning process.

Coordinating

9.12 A key aspect of the corporate governance framework is that the management structure and the lines of accountability (that is, who reports to whom), support implementation of identified strategies. For instance, a manager responsible for implementation of a compliance initiative requires sufficient control over the resources necessary to undertake the task.

9.13 As outlined in Chapter 5, in May 1997 WHT identified that its management structure hampered progress on some compliance initiatives. It therefore restructured its operations to ensure that senior executives responsible for running these projects and other projects also had direct control of resources. The ATO also advised that senior executive performance agreements have been revised to reflect their responsibilities within the new structure. The ANAO acknowledges that these changes will improve accountability and control.

Monitoring

9.14 The ANAO reviewed two aspects of monitoring: performance information and management reporting.

Performance information

- 9.15** Performance information can be derived from numerous sources. It can also be collated on a day-to-day basis or periodically, depending on the most cost-effective option. For instance, it may not be cost-effective to review the quality of every registration processed so a periodic review of a sample may be a better means of establishing quality. The ANAO reviewed WHT's use of OPS to measure daily activity and how this was supplemented by performance information collated on a periodic or specific basis.

Operational Performance Standards

- 9.16** WHT has several OPS to monitor ongoing, rather than specific, compliance initiatives. These are designed to measure aspects of performance including revenue collected, processing time of registrations and refunds, time to issue tax technical correspondence and time taken to answer phones. We examined the extent to which OPS broadly covered major ongoing compliance activities.
- 9.17** The ANAO found that there were OPS for each of WHT's major day-to-day activities such as administrative arrangements, technical correspondence and debt collection, but none for audit activity. Specifically, in 1996–97 there was no strategic OPS reported on by WHT that related to activities directed at ensuring compliance (described in Chapter 6 and including tax audits). A review of WHT planning material for 1997–98 revealed that it intended to develop appropriate OPS for these activities.
- 9.18** The ANAO also noted that current OPS do not include the associated costs of each activity. We consider this to be integral to monitoring of performance. For example, a sudden improvement in the number of registrations processed within 14 days of receipt of applications may have been due to an increase in staff resources. As current OPS do not incorporate costs in achieving certain goals, they provide minimal information on operational efficiency.
- 9.19** As outlined in Chapters 2 and 6, WHT has commenced implementation of a computer based Case Management, Reporting and Analysis tool (CaMRA). The system includes time recording functionality which will assist the recording of costs of the day-to-day compliance activities. In Chapter 2, we suggested that twelve months after it has been fully operational, WHT conducts an evaluation of CaMRA's effectiveness including its capacity to collate accurate and relevant cost data. Further, we suggest WHT reviews its OPS to include cost data collated through CaMRA.

Supplementing OPS

- 9.20** We found that the majority of OPS relate to turn-around times for activities, for example, the number of days to process a registration. As a result, the OPS do not monitor the quality of all of these activities (for instance, every registration processed), due to the likely cost. In earlier chapters the ANAO recommended or suggested that WHT implements quality assurance programs in key compliance activities, such as tax technical correspondence (Chapter 2), administrative arrangements (Chapter 5) and audit activities (Chapter 6). We consider that these programs will cost-effectively supplement the OPS information already collated.
- 9.21** As noted in the evaluation of planning material (see paragraph 8.4) the current OPS focus is on outputs (such as items processed) and there are minimal outcome measures other than the overall OPS for revenue collected. The challenge for WHT is to develop more appropriate and reliable outcome measures, such as the effect on revenue of certain compliance activities, for example, the revenue derived from issuing clear rulings or providing educational material. We noted in Chapter 4 that WHT undertook control testing of the introduction of primary producer check lists to ascertain the effect on revenue. We acknowledge that such an exercise may be costly if conducted on all compliance initiatives, but the development of outcome measures on key strategic compliance initiatives would be a cost-effective means of supplementing performance information.

Recommendation No.16

- 9.22** The ANAO *recommends* that to supplement existing Operational Performance Standards, WHT give priority to developing outcome measures, such as the effect on revenue, for key strategic compliance initiatives.

ATO Response

- 9.23** The ATO agrees with this recommendation. Changes are being made to the current planning process.

Management reporting

- 9.24** Reports on the progress toward implementing specific strategies and achieving particular goals, revenue targets and compliance activities, make an effective contribution to the coordination of existing compliance activities and planning. We found that WHT had developed internal reporting arrangements, including a monthly report which is presented to the WHT Executive Committee. This

report reviews each segment's performance against OPS and revenue targets and includes an economic analysis of each revenue line.

- 9.25** During 1996–97 the ATO also introduced a 'sign-off' process as part of its corporate governance framework. This involves business lines reporting on their performance against plans to the Commissioner and Second Commissioners on a quarterly basis.
- 9.26** The ANAO considers that these reports will improve management's monitoring of activity. However, we note that WHT corporate governance reports were not clearly structured to link with the goals and strategies outlined in the ATO and WHT plans, making it difficult to ascertain progress against all aspects of the plans. Although we acknowledge that factors to be reported on in corporate governance reports are determined by corporate areas, we suggest that WHT review the structure and content of these reports to improve the links with WHT plans.
- 9.27** In addition, the ANAO noted that the reporting of progress on specific compliance initiatives, such as the reform of the registration process, were primarily in a brief narrative format. This makes it difficult to objectively establish the progress and therefore, likely completion dates. We consider the lack in plans of clear milestones that can be reported against has contributed to this situation. Improvements in the use of planned milestones in WHT plans recommended earlier in this chapter will enable reporting on progress in implementing specific compliance initiatives to be clearer and more objective.

Conclusion

- 9.28** The ANAO noted that during the audit WHT completed a comprehensive evaluation of its planning process and that significant efforts have been made to address the recommendations arising from this evaluation. However, we consider that sales tax compliance management will benefit from WHT implementing the recommendations regarding planning and monitoring outlined in this chapter.
- 9.29**

10.

This chapter outlines the ANAO's assessment of coordination between the ATO and the ACS for sales tax. The audit concluded that there was significant scope for improvement in this area and that, until recently, the coordination of compliance activities between the ATO and the ACS had been limited. We noted, however, that during the audit the ATO and the ACS convened a liaison committee and entered into a Memorandum of Understanding to formalise arrangements.

Context

- 10.1** In addition to its other responsibilities, the ACS collected \$619 million of sales tax revenue on behalf of the ATO during 1996–97. As the law prescribes that sales tax applies to certain goods imported into Australia and as the ACS is responsible for the facilitation of trade in and out of Australia, the Commissioner of Taxation has delegated certain responsibilities to the ACS for collecting sales tax revenue on these goods.
- 10.2** The \$619 million was raised on goods with a total customs value of \$2.4 billion. The amount of sales tax payable is calculated by multiplying the taxable value by the sales tax rate applicable to the goods imported. The Assessable Dealings table⁵⁸ of the STAA prescribes the following formula for calculating the taxable value of goods at importation:

$$\text{Taxable value} = 1.2 \times (\text{customs value} + \text{duty payable})$$

- 10.3** The formula produces a taxable value which is intended to approximate the wholesale selling price of the goods if they had been sold by a wholesaler locally. The intended result is that the amount of sales tax paid on imported goods will be approximately the same as if they had been sold by a wholesaler in Australia.

10.4

⁵⁸ Table 1, Part B (Imported Goods), Schedule 1 of STAA.

10.5 Figure 4 illustrates the nature of goods incurring sales tax on importation by broad classification according to Schedule 3 of the *Customs Tariff Act 1995*. The figure shows that four broad groupings of products accounted for 77 per cent of the ACS sales tax revenue base.

10.6

Figure 4:
ACS sales tax collections (1996–97) by sections of Schedule 3 of the *Customs Tariff Act 1995*



10.7 Several importers choose not to pay sales tax at the time of importation through the use of exemption provisions in the law. To do this they quote a sales tax number or give an exemption declaration to Customs. There is a variety of reasons why taxpayers take advantage of the exemption provisions, including the capacity to defer sales tax liability to a subsequent sale or to use a more advantageous method of valuing their goods.

- 10.8** Another significant ACS sales tax role is the ‘drawback’ (refund) of sales tax paid to the ACS on certain imported goods which are subsequently exported. The Customs Act allows ‘drawbacks’ on these goods subject to certain conditions. In 1996–97 the ACS paid ‘drawbacks’ to 314 clients totalling \$7.6 million.

Background

- 10.9** Under section 8 of the *Taxation Administration Act 1953*, the Commissioner of Taxation has delegated a range of powers in the STAA to customs officers to enable the ACS to perform its sales tax role. The purpose of the delegation was to provide ACS officers with the legal authority to act on behalf of the Commissioner. It was not designed to explain the sales tax law or outline the roles of the respective agencies in terms of assistance they may provide to each other and how common activities might be coordinated.
- 10.10** The ANAO found that until recently the level of coordination between the ATO and the ACS had been limited to ad hoc exchanges of individual taxpayer data as a result of either agency’s audit activity, with a small number of ATO and ACS officers acting as contact points. A Memorandum of Understanding (MOU) existed to help the exchange of data at this case level. However, the MOU was not designed to clarify the respective roles and facilitate cooperation at a more strategic level and exchanges remained ad hoc. As noted in paragraph 9.14 below a new MOU was developed in June 1997.

ACS administration

- 10.11** The ACS collects sales tax using its infrastructure and administrative arrangements for the collection of duty. For instance, sales tax is calculated and raised in COMPILE, which is the ACS business system for customs and excise entry preparation and processing. Details of imports and associated duties including sales tax are entered into COMPILE by a self-assessing process, primarily by customs brokers, organisations with their own direct access and/or customs officers. These people and organisations may be unable to calculate the correct amount of sales tax if they do not understand some of the more complex aspects of sales tax.
- 10.12** As outlined in Chapters 1 and 2, an understanding of sales tax technical issues is critical to compliance management. Customs officers have limited opportunity to develop in-house expertise on how the law works because the ACS does not have overall administrative responsibility for the sales tax law. They also have minimal involvement in the formation of ATO rulings or ATO

administrative procedures, limiting their ability to maintain an understanding of how the law applies.

- 10.13** Although a significant proportion of transactions dealt with by customs officers may be technically straight forward, to ensure effective compliance management officers require sufficient knowledge of the sales tax schedules and supporting law to identify contentious issues. This ensures that issues involving a potential risk to revenue are referred to the ATO for expert advice where appropriate.
- 10.14** As the ACS and the ATO are addressing similar sales tax technical and compliance issues and given the ad hoc nature of their past sales tax exchanges, both agencies have recently recognised the potential benefits of improved coordination. During the course of the audit the agencies formed a liaison committee. As discussed below, the ANAO focussed on the committee's and thus the agencies' approach to improving coordination, with reference to the following:
- clarification of responsibilities and liaison;
 - sharing information;
 - coordination of compliance activities; and
 - coordination of compliance support activities.

Responsibilities and liaison

- 10.15** We found that a key consideration for the liaison committee has been to clarify the respective agencies' responsibilities with regard to sales tax administration. For instance, until recently there was some confusion over which agency was responsible for collecting outstanding sales tax debts for liabilities raised by the ACS.⁵⁹
- 10.16** The ATO and the ACS entered into a new MOU in June 1997 to formalise the ATO-ACS liaison committee and establish a framework for improving the relationship between the agencies. In addition to defining the sales tax responsibilities of each agency, the MOU sets out an agreement for mutual cooperation on sharing information, coordinating activities and regular liaison.

⁵⁹ The ATO and ACS subsequently agreed that where it is found that goods which were subject to sales tax at the time of importation have not been correctly taxed, it is the responsibility of the ACS to take appropriate action to ensure the correct tax is paid.

10.17 When announcing the signing of the MOU, the ACS Chief Executive Officer (CEO), Mr Lionel Woodward, stated that:

...One of the aims of the MOU is to establish a more effective information sharing and distribution system. In addition, it will formalise a high level Customs/ATO Liaison Committee established earlier this year to address strategic issues and to monitor progress...

The Commissioner of Taxation, Mr Michael Carmody stated that the:

...ATO recognises the important role Customs plays in the collection of sales tax on imported goods and the ATO will provide all necessary support to ensure effective administration. With the signing of the MOU, both agencies agree to work more closely on compliance activities including client education, audit and prosecution...

10.18 The liaison committee's terms of reference require it to:

- focus on strategic aspects of the ATO/ACS relationship and monitor overall progress on issues of mutual interest;
- oversee the progress of ATO/ACS working groups⁶⁰ and address issues arising from these groups requiring high level resolution; and
- prepare a brief annual report on progress, achievements, milestones and outstanding issues, etc.

10.19 The co-chairs of the committee have subsequently outlined the agenda for 1997–98, including the completion of a report outlining the committee's progress to be supplied to the Commissioner of Taxation and the CEO of the ACS. We endorse the progress the agencies have made during the audit and the formalisation of broad liaison arrangements, in particular the reporting requirement regarding the progress of the committee.

Compliance activities

10.20 As outlined in Chapter 1, direct compliance activities include enforcement (audit), education and administrative arrangements (for example, arrangements for payment). As there has been poor strategic coordination of these activities to date, an aim of the MOU is to improve the coordination of national activities. The ANAO analysed the payment profile of

⁶⁰ The MOU provides for working groups to be established for continuing liaison or specific projects.

ACS clients to identify opportunities for cost-effective joint-compliance management. We found that the top one per cent (542 clients) contributed 76 per cent of sales tax collections (\$470 million), with the top 61 clients contributing 50 per cent (\$309 million). We also found that over 90 per cent of ACS sales tax collections came from just six per cent of its sales tax payers.

- 10.21** In addition, the ANAO found that of the 314 clients receiving sales tax 'drawbacks' (that is, sales tax refunds from the ACS), the top ten accounted for 76 per cent of the total amount of sales tax drawn back, with the top 30 clients accounting for approximately 90 per cent.
- 10.22** The ANAO considers there would be significant benefit in the ATO and the ACS cooperatively managing the limited number of large ACS clients, especially as the revenue involved is significant and the ATO already has large segment teams and strategies to deal with the particular tax compliance issues associated with these clients. For instance, cooperative monitoring of these large clients could enable the agencies to better detect emerging compliance issues affecting these importers.
- 10.23** Specific coordination arrangements for these taxpayers will ensure that the ATO and the ACS treat clients who deal with both agencies in a consistent manner (for example, in terms of applying penalties and recovering sales tax debts). In addition, it is likely to reduce the compliance costs of a number of these clients, particularly those who currently deal with both agencies.
- 10.24** Similarly, improved direct coordination of certain administrative activities would lessen the risk of both agencies mistakenly paying the same refund to a client. Both the ACS and the ATO have acknowledged that this has occurred in the past, with a company as recently as 1996 mistakenly claiming and receiving the same sales tax refund (over \$1 million) from both agencies. In July 1997 at a compliance liaison committee meeting between the ATO and the ACS it was agreed that a more effective system for claiming 'drawbacks' and sales tax credits might be developed to ensure a more tightly controlled process to avoid the potential for duplicate claims.

Recommendation No.17

- 10.25** The ANAO *recommends* that the ACS and the ATO develop specific arrangements to coordinate the compliance management of the limited number of large ACS sales tax clients.

ATO Response

- 10.26** The ATO agrees with this recommendation. As part of the existing liaison arrangements this work is already being undertaken.

ACS Response

- 10.27** Agreed.

- 10.28** We noted that some ATO branch offices had conducted sales tax seminars for customs brokers. The performance of customs brokers influences compliance levels as they manage imports and raise sales tax liabilities on behalf of clients. We acknowledge the benefit of directly involving the ATO in providing education to customs brokers on tax matters, given their sales tax expertise. However, we consider there is substantial benefit in the agencies coordinating and targeting education using analysis of the ACS client data contained on COMPILE. Figure 5 outlines the primary source of sales tax entries as recorded on the system.

- 10.29** The results in Figure 5 suggest that a significant proportion of sales tax revenue is raised via entries in COMPILE by a limited number of brokers and COMPILE users. The efficiency and effectiveness of compliance activities, including education, directed at brokers and COMPILE users can be considerably enhanced by targeting activities based on revenue implications. For example, individual monitoring and education would be cost-effective for the small number of brokers responsible for a large proportion of ACS sales tax revenue.

Figure 5:
Analysis of sales tax payments to ACS (1996–97) by source of entry

Recommendation No.18

- 10.30** The ANAO *recommends* that joint ATO/ACS sales tax compliance activities, such as education directed at customs brokers and COMPILE users, be targeted based on analysis of the ACS sales tax client population.

ATO Response

- 10.31** The ATO agrees with this recommendation. As part of the existing liaison arrangements this work is already being undertaken.

ACS Response

- 10.32** Agreed.

Compliance support activities

- 10.33** To manage their respective revenue responsibilities,⁶¹ both the ATO and the ACS undertake a range of support activities to ensure that compliance activities are efficiently and effectively conducted. These include writing improved procedures, improvements to and testing of administrative systems (to calculate and record tax liabilities), training programs for staff and producing better support analysis tools, among others.
- 10.34** As outlined in Chapter 7, the ATO has a sales tax curriculum aimed at improving staff skills. The ACS acknowledged that it requires a certain level of sales tax knowledge to ensure that the correct sales tax revenue is collected at importation. We consider there are benefits in the ACS using relevant aspects of the ATO sales tax training curriculum.
- 10.35** Similarly, business systems play a significant role in collecting revenue; as both agencies record taxpayer details, payments and refunds as well as calculating liabilities in some instances. The capacity to compare practices will help further refine systems.
- 10.36** ANAO analysis of ACS data revealed that in 1996–97 the ACS business system had allowed twenty different sales tax rates to be used in sales tax liability calculations. The law stipulates five (other than zero). Table 5 below illustrates that 952 transactions were calculated at incorrect rates, primarily by brokers but also by organisations with direct COMPILE access and by Customs staff.

⁶¹ Noting that both agencies also have non-revenue duties.

Table 5:
ACS sales tax rate analysis for 1996–97

	No. of transactions where sales tax paid	Sales tax paid (\$)
Valid sales tax rate applied (1)	644 899	618 807 785
Invalid sales tax rate applied		
Entered by brokers	810	246 760
Entered by COMPILE users	127	19 719
Entered by Customs	<u>15</u>	<u>3 683</u>
Total invalid sales tax rates	952	270 162
Total	645 851	619 077 947
Percentage of total invalid rates	0.15%	0.04%

Note (1): Includes transactions where sales tax has been manually calculated.

10.37 The amount of revenue associated with the incorrect rates for the 1996-97 period was relatively small (\$270 162 from 952 transactions). The ACS advised that it initiated corrective action for the business system. Nevertheless, we suggest the ACS explores the full extent of revenue at stake as a result of these errors and where appropriate, seek revenue adjustments from affected taxpayers.

10.38 The ANAO also considers that the bench-marking of system change practices and testing procedures (particularly with regard to law changes) between the two agencies would reduce the likelihood of such system errors occurring or remaining undetected for extended periods.

Recommendation No.19

10.39 The ANAO *recommends* that the ACS and the ATO review their respective sales tax support activities for commonalities and better practices to ensure greater efficiency and effectiveness.

ATO Response

- 10.40** The ATO agrees with this recommendation. As part of the existing liaison arrangements this work is already being undertaken.

ACS Response

- 10.41** Agreed.

Market intelligence

- 10.42** The ATO and the ACS acknowledged the benefits of sharing market intelligence by agreeing in the MOU to share information and to liaise on issues of mutual interest (within the confines of the relevant legislation). Both organisations have been developing compliance strategies based on teams responsible for market segments which will facilitate the identification of agency contacts and exchange of market intelligence between teams. We noted that one of the liaison committee's priorities for 1997–98 is to form protocols for information and data exchange.
- 10.43** The ANAO considers an area of potential risk to the revenue base is when importers quote sales tax numbers to the ACS to import goods free of sales tax. As the ATO issues these numbers to taxpayers there would be significant benefit derived from the exchange of information between the agencies to enable verification and validation of these exemption claims.
- 10.44** The ANAO observed that the arrangements in this regard had been limited to the ATO giving the ACS a mathematical formula for preliminary screening of numbers to identify those which are potentially invalid, although it cannot detect all invalid numbers. We therefore cross-matched sales tax numbers quoted to the ACS in 1996–97 for the purposes of exemption with the ATO sales tax database.
- 10.45** As illustrated in Table 6 below, we found that 1.6 per cent (562) of the numbers quoted and accepted by the ACS did not exist on the ATO business systems as registered numbers and therefore are potentially invalid. If the numbers are invalid, quotations made with them are illegal. An additional 3.4 per cent (1209) of the numbers accepted by the ACS for quotation purposes had been cancelled by the ATO before 1996–97 and therefore quotations made with these numbers are illegal.

Table 6:

ANAO cross matching of ATO sales tax registration numbers with numbers quoted for exemption purposes to the ACS in 1996–97

Matching group	Number	Per cent of total
Matched and not cancelled	33 201	92.6
Matched and cancelled in 1996–97	867	2.4
Matched and cancelled before 1996–97	1 209	3.4
Not matched with ATO business system	562	1.6
Total	35 839	100.0

10.46 Table 6 also shows that 2.4 per cent of numbers quoted to the ACS in 1996–97 had been cancelled by the ATO during that year. While some of these may have been cancelled after quotation, the ANAO considers that it is likely that a proportion of quotations made with these numbers were also illegal. We acknowledge that in some instances goods subject to incorrect quotations may have been exempt from sales tax for other reasons. Further, as the 35 839 numbers on COMPILE were quoted on over 1.5 million customs entries (an average of 44 entries per number quoted) in 1996–97, we consider it is likely that these invalid sales tax registration numbers were quoted on goods more than once during that year.

10.47 The sales tax legislation recognises misuse of sales tax numbers as a critical issue and prohibits improper quoting. Section 91 of the STAA prescribes a penalty of \$2000 for offences by persons falsely representing themselves as registered persons, quoting sales tax registration numbers when not entitled to do so or falsely quoting sales tax numbers in any other way. In addition, the sales tax law provides that where goods are obtained tax free a liability to sales tax will arise if the goods are subsequently used for a non-exempt purpose.

Recommendation No.20

10.48 The ANAO *recommends* that the ACS and the ATO investigate the extent of false quotations (of sales tax numbers) to the ACS for exemption purposes and where appropriate take corrective action.

ATO Response

- 10.49** The ATO agrees with this recommendation. The ATO advises that as part of the existing liaison arrangements this work is already being undertaken. The ATO is analysing ANAO's data and will pursue the ANAO findings on possible misquotation of sales tax numbers at time of importation as a priority task. However, initially more work is needed to adequately assess the significance of the risk involved. For example, the value of the transactions identified both individually and in aggregate will have a significant bearing on the magnitude of the risk. Other factors need to be examined such as the extent to which the misquotation is due to a numerical transposition error and the extent to which the transaction is intended to be 'tax-free' but the quotation is numerically incorrect. It may be that the risk to revenue at importation is low because all but a small amount of WST liability at importation rests with a relatively few large taxpayers.

ACS Response

- 10.50** Agreed.
- 10.51** The system of quotation of sales tax numbers is a fundamental element of the sales tax system. Possession of a sales tax number enables tax free purchases of goods (subject to the rules governing quotation). The relatively high level of illegal quotations to the ACS undermines the integrity of the sales tax system and is potentially a serious risk to revenue. Significant benefit can be derived from implementing measures to prevent the quotation of invalid numbers for exemption purposes.
- 10.52** The ANAO is concerned that the current system does not detect quotations of cancelled sales tax numbers. Similarly, existing arrangements are not sufficiently rigorous to prevent acceptance of numbers that have not been issued by the ATO. It is possible that some of these numbers are being produced and used as part of a fraud on the Commonwealth's sales tax revenue.
- 10.53** New measures that involve data matching with the ATO database will assist the ACS to reduce the number of invalid quotations. Both agencies have experience with data matching technology which provides an opportunity for such measures to be cost-effective.

Recommendation No.21

- 10.54** The ANAO *recommends* that the ATO and the ACS establish a program for cross-matching sales tax numbers quoted to the ACS to reduce the incidence of invalid sales tax numbers being quoted for exemption purposes.

ATO Response

- 10.55** The ATO agrees with this recommendation.

ACS Response

- 10.56** Agreed.

- 10.57** The ANAO did not establish whether the 33 145 valid sales tax registration numbers quoted to Customs in 1996–97 had been correctly quoted by authorised people. We suggest that the agencies explore strategies for matching client data to establish that valid sales tax numbers quoted to the ACS have been provided by those taxpayers registered by the ATO to use them.



Canberra ACT
4 December 1997

P. J. Barrett
Auditor-General

Part Three

Appendices

Appendix 1

Building blocks of sales tax - Steps to determine the amount of tax payable

Step 1: Are the goods 'assessable goods'?

General explanation (1)	Only assessable goods can be subject to sales tax (Goods means any form of <i>tangible</i> personal property). Assessable goods are goods manufactured in Australia or imported into Australia but do not include goods that have been used in Australia.
Statutory references	Schedule 1, Table 1, Note 1 of <i>Sales Tax Assessment Act 1992 (STAA)</i> states that an assessable dealing does not exist unless the goods dealt with are 'assessable goods'. Section 5 of <i>STAA</i> contains definitions of key concepts.

Step 2: Is there an 'assessable dealing'?

General explanation (1)	Sales tax is not payable unless there is an 'assessable dealing' with assessable goods. The sales tax law prescribes 23 kinds of assessable dealings.
Statutory references	Schedule 1, Table 1 of <i>STAA</i> contains descriptions of all assessable dealings.

Step 3: Does an exemption apply?

General explanation (1)	An assessable dealing with assessable goods is taxable unless an exemption applies. Some goods, for example, food, clothing and building materials, are always exempt from sales tax. Some are exempt if they are used in a particular way or by particular people or organisations. Some goods are exempt if they are to be exported or are covered by the small business exemption. The law contains lists of exempt goods and a number of rules about exemptions.
Statutory references	Schedule 1 to <i>Sales Tax (Exemptions and Classifications) Act 1992</i> lists 195 sales tax exemptions organised into 15 chapters. Sections 82 and 83 of <i>STAA</i> contain lists of grounds under which goods can be bought tax free by quoting sales tax registration numbers or by quoting exemption declarations.

Step 4: What is the taxable value of the goods?

General explanation (1)	If there is an assessable dealing and no exemption the taxpayer must establish the taxable value of the dealing. The sales tax law prescribes a taxable value for each kind of assessable dealing.
Statutory references	Schedule 1, Table 1, Column 5 of <i>STAA</i> shows the taxable value for each kind of assessable dealing. Part 3, Division 3 of <i>STAA</i> contains general and special rules concerning taxable values and substitute taxable values.

Step 5: Is there any part of the taxable value that is exempt from sales tax?

General explanation (1)	Sometimes, a part of the taxable value is exempt from tax, for example, goods containing certain computer programs, goods incorporating solar panels or goods incorporating a milk tank.
Statutory references	Part 3, Division 4, STAA contains the rules about exempt parts of taxable values.

Step 6: How much tax do I pay?

General explanation (1)	<p>Tax payable = (Taxable value - exempt part) × rate.</p> <p>In addition to the range of exemptions, there are currently 5 rates of tax that may be applicable: 12, 22, 26, 32 and 45 per cent. The rate applicable to particular goods depends on which classification they fall under in the Schedules to the <i>Sales Tax (Exemptions and Classifications) Act 1992</i>.</p>
Statutory references	Sub-section 16(3), STAA prescribes how to calculate the final liability. The schedules to the <i>Sales Tax (Exemptions and Classifications) Act 1992</i> contain lists of goods. All goods covered by a particular schedule are taxed at the rate appearing at the head of that schedule. For example, the rate for Schedule 2, which covers a number of household goods, is 12 per cent.

Step 7: What am I required to tell the Commissioner of Taxation?

General explanation (1)	Taxpayers have the option to register for sales tax purposes. Taxpayers registered for sales tax can acquire a range of business inputs exempt from sales tax by quoting their registration numbers. Registration is outlined further in Chapter 5 as part of the discussion of administrative arrangements. Similarly, taxpayers under the STAA are obliged to update registration details, pay sales tax (if they have a liability) and lodge returns.
Statutory references	Sections 78, 81 and 113 of STAA prescribe when a person is entitled to register and rules about information to be supplied to the Commissioner and the Commissioner's general powers to prescribe the form and content of information to be provided. Section 81 requires taxpayers to notify of changes in circumstance relevant to registration, with Part V, STAA prescribing return lodgment and payment requirements.

Step 8: How else does the sales tax law affect me?

General explanation (1)	The sales tax law contains a diverse range of provisions that may affect many taxpayers, government and community bodies and individuals. For example, there are 31 refund provisions and numerous provisions related to documentation in addition to special rules for leasing (various sections), containers (section 35), royalties (section 36), small business exemption (section 29), exemptions for goods to be exported (sections 30-32) and tax-free sales to international tourists (numerous provisions).
Statutory references	Various provisions

Note 1 : *The explanations and statutory references provided above are for explanatory purposes and are not intended to be a complete and legally precise description of the law.*

Appendix 2

Example of the decision framework applicable to a transaction

Taxpayer decisions This appendix illustrates some of the sales tax implications of the variety of circumstances that may arise for businesses affected by sales tax such as retailers, wholesalers, manufacturers and importers and businesses which may involve two or more of these activities (The example of chairs is used for illustrative purposes). The decisions relate to the first six steps outlined in Appendix 1.

Step 1

Assessable goods: The nature and source of trading stock determines whether a good is 'assessable' and therefore whether or not the taxpayer may have to pay sales tax. For example:

- imported new chairs, imported second-hand chairs and imported new or second-hand chair components are assessable goods;
- chairs that have become second-hand by being used in Australia are not assessable goods;
- chairs manufactured from imported second-hand chair components are assessable goods;
- chairs manufactured in Australia are assessable goods; and
- chairs manufactured from second-hand chair components and sold as second-hand chairs are not assessable goods.

Step 2

Assessable dealings: Assessable dealings are not limited to the sale of goods.

Taxpayers need to be aware of the variety of events, that may (or may not) be classified as an assessable dealing and therefore potentially taxable. For instance:

- the sale of chairs which are not assessable goods is not an assessable dealing;
- the wholesale sale of chairs classified as assessable goods is an assessable dealing;
- generally, the retail sale of chairs on which tax has been paid is not an assessable dealing;
- the retail sale of chairs by their manufacturer is an assessable dealing;
- leases of chairs, the use of chairs as demonstrator stock, the loan of chairs or the donation of chairs are all assessable dealings; and
- the loss of chairs through theft or destruction before a sale or some other dealing is not an assessable dealing.

Step 3

Exemptions: If there is a an assessable dealing with assessable goods, tax will be payable unless an exemption applies. The taxpayer dealing with the chairs therefore needs a clear understanding of the ways an exemption might apply. For example, if:

- chairs are sold to a person who quotes a sales tax number, for example, a wholesaler, an exemption applies;
- chairs are sold to a person who quotes an exemption declaration, for example, a public hospital or local government body, an exemption applies;
- chairs are sold by a person who has an annual sales tax liability less than \$10 000 the transaction may be exempt under the small business exemption;
- chairs are to be leased to a lessee entitled to claim a sales tax exemption, an exemption (or reduction in taxable value) may apply; and
- the seller or purchaser intends to export the chairs, an exemption may apply.

Step 4

Taxable value: The sales tax law prescribes a taxable value for each type of assessable dealing. Examples of taxable values applicable to dealings with chairs include if:

- the chairs are sold to a retailer the taxable value is the selling price;
- the chairs are sold to a wholesale chair distributor the taxable value is the selling price;
- the chairs are sold direct to a consumer the taxable value is the price that could reasonably have been expected for the chairs if sold by wholesale under an arm's length transaction. (It may be necessary to read the ATO's 51 page ruling on taxable values or to approach the ATO to obtain a written ruling or consult tax advisers.);
- the chair manufacturer decides to use some of the chairs in the factory office the taxable value is the price for which the manufacturer could reasonably have been expected to sell the chairs by wholesale under an arm's length transaction; and
- chairs are imported for sale to consumers the taxable value is 120% of (customs value + customs duty). (In this case the sales tax is paid to Customs at the time the chairs are imported).

Step 5

Exempt part of taxable value: In the case of chairs the only likely instance where part of the taxable value may be exempt from sales tax would be if the chairs are subject to a short-term lease in circumstances where the lessee is entitled to exemption.

Step 6

How much tax is payable?:

Amount of tax payable = (taxable value - exempt part) × rate.

The amount of tax therefore depends on the taxable value, any exempt part of taxable value and the sales tax rate applicable to chairs. Examples of taxable values are set out above. The sales tax rate on household chairs is 12 per cent. The rate applicable to commercial chairs is 22 per cent. However, chairs that are used by disabled people or for medical purposes (as prescribed in the legislation) may be exempt and therefore attract no sales tax. As the distinction between these classifications of chairs could be unclear it may be necessary to consult tax advisers or obtain a written ATO ruling on which rate to apply.

If commercial chairs are sold to a non-exempt customer for \$1000, excluding tax, the amount of tax payable will be:

$$(\$1000 - 0) \times 0.22 = \$220.$$

Appendix 3

ATO Business and Service Line Structure

37. The ATO has based its organisational structure around particular client groups. In addition, it has established a specialist tax law program and created specialist functional groups to assist the client group programs.

38. The ATO's client group programs as at April 1997, around which the organisation focuses its program delivery, are listed below:

- *Individuals Non Business*: deals with salary and wage earners and investors;
- *Small Business Income*: taxpayers are businesses with annual turnovers of less than \$10 million; also deals with fringe benefits tax matters for all taxpayers;
- *Large Business and International Income (called Large Business Income from 1994 to April 1997)*: taxpayers are large corporate groups with annual turnovers in excess of \$10 million; also deals with international tax;
- *Withholding and Indirect Taxes*: includes prescribed payments, sales tax and Pay-As-You-Earn (PAYE);
- *Superannuation*: responsible for relevant superannuation policy and administration of Superannuation Guarantee and Reasonable Benefit Limit; and
- *Child Support Agency*.

39. The ATO has set up the following separate support programs to take responsibility for the tax technical service delivery:

- *Legislative Services Group*; and
- *Tax Counsel and Practice Management Group*.

40. The corporate, financial and information technology needs for the client group programs are provided by the following support programs:

- Financial Services;
- Corporate Services; and
- Information Technology Service.

41. The ATO stated that it expects that this organisational structure will be of benefit by enhancing output and placing greater emphasis on taxpayer compliance strategies, taxpayer education, and being accountable for outcomes.

Appendix 4

WHT Market Segment and Team Structure

The following diagram sets out the WHT segment and team structures which were in place during the audit. As noted earlier in this report, WHT has recently commenced restructuring its segments by regrouping the New and Small/Medium Established segments into Small and Micro business segments.

Appendix 5

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