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Performance Audit

# The Australian Taxation Office's Strategies to Address Tax Haven Compliance Risks

## Australian Taxation Office

Australian National Audit Office

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Canberra ACT
29 May 2008

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Australian Taxation Office in accordance with the authority contained in the *Auditor-General Act 1997*. I present the report of this audit and the accompanying brochure to the Parliament. The report is titled *The Australian Taxation Office's Strategies to Address Tax Haven Compliance Risks.*

Following its tabling in Parliament, the report will be placed on the Australian National Audit Office's Homepage—http://www.anao.gov.au.

Yours sincerely

Ian McPhee
Auditor-General

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

**AUDITING FOR AUSTRALIA**

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# Abbreviations

| | |
|---|---|
| ANAO | Australian National Audit Office |
| ATP | Aggressive Tax Planning |
| AUSTRAC | Australian Transaction Reports and Analysis Centre |
| CPS | Community Perceptions Survey |
| HOTSA | Health of the System Assessment |
| NCSP | National Case Selection Panel |
| OCP | Offshore Compliance Program |
| OECD | Organisation for Economic Cooperation and Development |
| OECD Forum | Organisation for Economic Cooperation and Development Forum on Harmful Tax Practices |
| OVDI | Offshore Voluntary Disclosure Initiative |
| SNC | Serious Non-Compliance |
| Tax Office | Australian Taxation Office |
| THAG | Tax Haven Advisory Group |
| THSC | Tax Haven Steering Committee |

# Summary and Recommendations

# Summary

## Introduction

**1.** Australian resident taxpayers are subject to tax on their worldwide income. Accordingly, Australia's taxation system of self assessment places a responsibility on taxpayers to declare all of their assessable income and claim only deductions and/or offsets to which they are entitled.

**2.** Tax havens seek to attract international trade and investment by establishing financial, legal and tax systems that may be beneficial to some activities. The systems that make tax havens attractive for legitimate purposes may also be used in arrangements designed to evade paying tax elsewhere, or for other criminal pursuits. The illegitimate use of tax havens is a problem for many countries, including Australia. The compliance risks associated with the use of tax havens for the Australian Taxation Office's (Tax Office) and the community is that the illegitimate use of tax havens adversely affects the revenue base and has the potential to affect confidence in the administration of the tax system.

**3.** The Tax Office, as Australia's principal revenue agency, has responsibility for administering Australia's tax system under the law. The Tax Office's business model includes a compliance program which outlines the approach taken to encourage high levels of voluntary compliance with the law. The compliance risk model seeks to allocate compliance resources to areas identified as having the highest risk.

**4.** The Tax Office's analysis of Australian Transaction Reports and Analysis Centre (AUSTRAC) data shows that from 2001–02 to 2005–06 total direct transfers to and from tax havens has increased from A$5.8 billon to A$13.7 billion, an increase of more than 230% over the five year period. The Tax Office uses this information, empirical data from case work and intelligence gained from overseas experience as part of their risk identification and assessment. As a consequence, the Tax Office for the last several years has identified international tax risks, with a specific focus on tax havens (and other low tax jurisdictions that maintain banking secrecy—referred to as preferential regimes), as being a 'headline issue' warranting increased compliance activities.[1]

**5.** Ensuring tax payer compliance in respect of tax havens is challenging; in general the extent of the tax avoidance risk is difficult to determine due to concealment and the lack of transparency in particular tax haven jurisdictions. The nature of the risk is also constantly changing as taxpayers and their advisers become more sophisticated and knowledgeable in their approach to tax compliance.

**6.** The Tax Office's response to their identification and assessment of risks relating to the illegitimate use of tax havens has included a range of risk treatment strategies such as active compliance and audit work, treaty negotiations, disclosure initiatives, participation in international forums, and also increased education and marketing.

**7.** The Tax Office is not solely responsible for addressing tax haven compliance issues in Australia. The Australian Crime Commission, the Australian Federal Police and the Commonwealth Director of Public Prosecutions share responsibility for litigating illegitimate tax haven related schemes. At a government level, the Treasurer, with assistance from the Department of the Treasury (Treasury), is responsible for initiating changes to tax legislation, and for negotiating tax treaties that protect Australia's right to tax international transactions.

## Audit objective and scope

**8.** The objective of the audit was to assess the Tax Office's strategies to address tax haven compliance risks. Particular emphasis was given to the Tax Office's:

- management arrangements relating to the administration of tax haven compliance risks;
- risk management framework for the identification and evaluation of compliance risks, specifically the activities of the Offshore Compliance Program (OCP); and

[1] The Tax Office collectively refers to their compliance activity in this area as being focused on 'abusive offshore arrangements' (Tax Office, *Tax havens and tax administration*, October, 2007, p 3). Note that while the focus of this audit was on the Tax Office's strategies to address tax haven compliance risks, as a result of the approach of the Tax Office, the audit focus extended beyond defined 'tax havens' to include 'abusive offshore arrangements'. References in this report to the Tax Office's strategies to address 'tax haven' compliance risks should be taken to apply equally to the Tax Office's strategies to address 'abusive offshore arrangements' compliance risks.

- risk mitigation strategies.

**9.** The audit did not include an examination of cases related to the promoters of tax haven related schemes nor the criminal use of tax havens.

## Conclusion

**10.** The concealment of assets and income in offshore arrangements presents significant challenges for the Tax Office. The inability to easily access information beyond Australia's jurisdiction presents difficulties in fully understanding the nature of taxpayers' offshore transactions. This is compounded in countries where banking and legal frameworks ensure that information is not disclosed to third parties. The impact for the Tax Office and the community is that the illegitimate use of tax havens adversely affects the revenue base and has the potential to affect confidence in the administration of the tax system. In these circumstances, the Tax Office's compliance approach needs to be constantly evolving, employing a range of effective strategies and leveraging from domestic and international experience.

**11.** The Tax Office has adopted a risk management framework for its compliance program where risks are identified and assessed, and in response treatment mitigation strategies are developed, implemented and evaluated. Within the Tax Office's risk management model, there are specific management arrangements to mitigate the tax haven compliance risks. This comprises a combination of oversight committees, intelligence areas and compliance staff from a number of operational areas to undertake specialist audit work. The framework had been adjusted to provide enhanced governance and appropriate focus on the risk and whole of Tax Office co-ordination at both formal and informal levels. However, at a formal level the key steering committee responsible for determining strategic direction has not yet met in accordance with its charter, thus not providing the expected high level co-ordination for the Tax Office's approach to managing the identified tax haven compliance risks. The Tax Office can improve its governance of tax haven risks by ensuring this key strategy setting committee meets on a regular basis in accordance with the terms set out in its charter.

**12.** The Tax Office has employed a variety of strategies to identify and evaluate tax haven compliance risks on an ongoing basis. This includes: the use of information collected by AUSTRAC; empirical data from business lines; and intelligence gained from overseas experience and Tax Office participation. The additional resources that have been applied through the new strategies and compliance activities should provide a stronger basis for informed risk identification by the Tax Office. However, the Tax Office could improve its assessment of the extent of the risk through greater trend analysis of qualitative and quantitative data, particularly in the use and increased analysis of AUSTRAC data. This is particularly important as funds may be transferred in the first instance to a country which is not a tax haven. Any subsequent transfers are extremely difficult to monitor by the Tax Office.

**13.** The Tax Office is currently undertaking a variety of treatment strategies to mitigate the assessed tax haven compliance risks. These include: targeted active compliance and audit work; marketing and education; and treaty negotiations. These compliance activities assist in continually informing the Tax Office of the changing nature and extent of tax haven compliance risks. The Tax Office also effectively leverages from its significant involvement in international forums.

**14.** The evaluation of the tax haven compliance treatment strategies is an important tool for the Tax Office in the final stage of their risk management process. The Australian National Audit Office (ANAO) found the method of measurement did not necessarily inform the extent of success of the Tax Office's strategies; there was often no direct link between the measurement and the key outcome. A key management challenge for the Tax Office is how to measure the effectiveness and utility of their compliance strategies as they evolve in response to the changing nature of the risks.

**15.** The ANAO made three recommendations aimed at improving the Tax Office's ability to measure the effectiveness of their strategies to address tax haven compliance risks. The recommendations relate to the management of the strategic risk, the assessment of the extent of the risk and the measurement of the effectiveness of their compliance strategies.

## Key findings by chapter

### Background (Chapter 1)

**16.** Australia is part of a dynamic global economy that presents a variety of opportunities for individuals and businesses of all sizes to more easily trade offshore with countries that can have very different financial and legal systems to that of Australia.[2] Tax havens seek to attract international trade and

2 References in this Report to 'countries' should be taken to apply equally to 'territories', 'dependencies' or 'jurisdictions'.

investment by establishing financial, legal and tax systems that may be beneficial to some activities. Modern communication methods and the internet have made it easier for financial services to be provided from previously remote locations.

**17.** The Tax Office's analysis of AUSTRAC data reveals that most direct transactions between Australia and tax havens are lawful international dealings and not attempts to evade tax payable in Australia. The systems that make tax havens attractive for legitimate purposes may also be used in arrangements designed to evade paying tax elsewhere, or for other criminal pursuits.

**18.** The Tax Office defines a tax haven based on three key factors:

- it imposes **no or nominal taxes** and can be used by non-residents to escape tax in their country of residence;
- there is a **lack of effective exchange of information** with outside tax authorities based on strict secrecy rules and other protections; and
- there is a **lack of transparency** in the operation of its legislative, legal or administrative provisions, making it difficult, if not impossible, for other tax authorities to apply their laws effectively and fairly.

These criteria are based on the definition used by the Organisation for Economic Cooperation and Development (OECD), of which Australia is a member. The Tax Office has identified 32 tax havens—see Appendix 2.

**19.** Tax Information Exchange Agreements (TIEA) are used by OECD countries to assist in overcoming the lack of access to specific transactional information in countries considered to be tax havens. When Australia enters into a TIEA with a tax haven, the Tax Office no longer identifies that country as a tax haven (the particular country may still be monitored as a part of the Tax Office's focus on abusive offshore arrangements). Australia has entered into three TIEAs, and is in the process of negotiating another seven, the Isle of Man has agreed to sign a TIEA.[3]

**20.** The Tax Office is not solely responsible for addressing tax haven compliance issues in Australia. The Australian Crime Commission, the Australian Federal Police and the Commonwealth Director of Public

[3] Australia has entered into a TIEA with Antigua and Barbuda, Bermuda and the Netherland Antilles. Australia is in the process of TIEA negotiation with Anguilla, Aruba, British Virgin Islands, Jersey, Grenada, Guernsey, and Nauru.

Prosecutions share responsibility for litigating illegitimate tax haven related schemes. At a government level, the Treasurer with assistance from the Treasury is responsible for initiating changes to tax legislation, and for negotiating tax treaties that protect Australia's right to tax international transactions.

**21.** The Tax Office, as Australia's principal revenue agency, has responsibility for administering Australia's revenue system under the law. To mitigate against the potential illegitimate use of tax havens, the Tax Office relies on taxpayers having the right information and support to ensure voluntary compliance as well as employing a range of enforcement activities. Within the Tax Office responsibility for managing the haven compliance risks is shared across numerous business lines and executive forums with differing responsibilities and accountabilities.

## Management arrangements (Chapter 2)

**22.** Development and implementation of sound governance arrangements supports the effective management of agencies' programs and service delivery. The tax haven compliance risk manifests itself across numerous business lines within the Tax Office. The Tax Haven Steering Committee (THSC) was set up in 2007 to be the main strategic body providing leadership and direction on tax haven matters across the Tax Office.

**23.** The ANAO found that the THSC was not executing its roles and responsibilities as set out in its charter, thus not providing the expected high level co-ordination for the Tax Office's approach to managing the identified key tax haven compliance risks. The Tax Office can improve its governance of the tax haven risk by ensuring that the THSC meets on a regular basis in accordance with the terms set out in its charter.

**24.** The Tax Haven Advisory Group (THAG) is the main operationally based forum covering tax haven compliance risks, with responsibilities incorporating monitoring and reporting on tax haven risks, active compliance case work and compliance program outcomes across all affected business lines. The information sharing aspect is an important mechanism for intra Tax Office intelligence sharing reflecting its more operational focus. The THAG is performing an effective role as the operational based forum for tax haven compliance risks.

**25.** The Tax Office has an established planning framework. The ANAO analysis showed that the Tax Office's planning documents reflect the risks associated with tax haven compliance and are clearly linked and cross referenced to particular outputs. The business lines' delivery plans identified the particular initiatives and program of work, while the team and individual plans reflect their overall responsibilities and areas for improved performance.

**26.** The Tax Office has responded to the increased public and parliamentary interest in tax haven related activities with regular external reporting of tax haven compliance activities. The Tax Office utilises a variety of forums to report on activities including their annual report, specific publications, media releases and speeches. The ANAO found the internal reporting generally aligned with the Tax Office wide reporting structure and provided a framework to support the ongoing management of tax haven compliance risks. The ANAO identified a lack of consistency of reporting particularly in relation to the Tax Office's annual reports which made trend analysis difficult.

## Tax haven compliance risks (Chapter 3)

**27.** Compliance risk management *is a structured process for the systematic identification, assessment, ranking and treatment of tax compliance risks*.[4] Treating tax haven compliance risks is particularly difficult; in general the extent of the tax avoidance risk is difficult to determine due to concealment and the lack of transparency in particular tax haven jurisdictions. The nature of the risk is also constantly changing as taxpayers and their advisers become more sophisticated and knowledgeable in their approach to tax compliance.

**28.** The ANAO found that the Tax Office had adopted a sound risk management framework for tax haven compliance risks. The Tax Office's business model reflects the compliance risk model and seeks to allocate its compliance resources to areas identified as having the highest risk. The Tax Office publishes its *Compliance Program* annually which describes the Tax Office's overall approach to managing compliance, discusses the risks associated with Australia's revenue system, and how the Tax Office proposes to treat those risks. For the last six *Compliance Programs*, International tax risks, with a specific focus on tax havens has been identified as a headline issue warranting increased compliance activities and resources.

**29.** The ANAO found that the Tax Office uses a variety of techniques to inform their understanding of the compliance risks relating to tax havens

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[4] OECD, 2004. *Compliance Risk Management: Managing and Improving Tax Compliance,* Centre for Tax Policy and Administration Guidance Note, p. 8.

including the use of AUSTRAC data, business line case experience and participation in international activities. The Tax Office uses this intelligence to inform their risk analysis, assessment and responses through a centralised unit for tax haven compliance risks. Through the centralised unit the Tax Office is able to leverage the combined intelligence to perform sound risk assessments and appropriate treatment of the risks including potential case work.

**30.** The Tax Office uses a variety of criteria to evaluate the level of risk in relation to tax haven compliance including: materiality, seriousness, and likelihood of recurrence. The evaluation of risks must take place within the context of the nature and extent of the risk. Through analysis and past compliance work, the Tax Office has gained an understanding of the nature of the risk. The Tax Office has also previously attempted to measure the extent of the risk at a broad level. While the historically based measurement was done with little detailed analysis, it is still currently used in part for resource justification and risk work. The Tax Office could improve its assessment of the extent of tax haven compliance risks through greater trend analysis of qualitative and quantitative data, particularly in the use and increased analysis of AUSTRAC data. This is particularly important as funds may be transferred in the first instance to a country which is not a tax haven. Any subsequent transfers are extremely difficult to monitor by the Tax Office.

## Tax haven compliance activities (Chapter 4)

**31.** The Tax Office uses a range of risk treatment products to mitigate tax haven compliance risks. The Tax Office's overall aim for compliance is to achieve high levels of voluntary compliance. This is facilitated by a Compliance Program that: '….involves a mix of help and information (including helping taxpayers deal with us online at minimal cost and effort) and verification and enforcement activities (such as risk reviews, audits and prosecutions)'.[5]

**32.** The Tax Office produces a wide range of education and information products and provides a number of services to assist people and entities in meeting their taxation obligations. This includes the specific *Tax havens and tax administration*[6] booklet, a comprehensive document outlining the key risks for taxpayers and promoters and how the Tax Office deals with tax haven arrangements. The ANAO notes that within the OECD, the Tax Office is alone

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5 Tax Office, *Compliance Program 2007–08*, p. 5.

6 Tax Office, *Tax havens and tax administration*, October, 2007.

as a revenue body having a publicly available strategy document regarding tax haven compliance issues. The booklet is a positive element of the broader education approach.

**33.** The Tax Office has recently embarked on a range of active compliance activities following the implementation of the revised tax haven strategy. Many of the initiatives were in the rollout phases as at November 2007 including an Offshore Voluntary Disclosure Initiative, and increased audit work on high risk cases. The Tax Office should be able to leverage from the increased activity in this area to enhance their compliance risk understanding and their compliance focus.

**34.** The Tax Office is actively involved in international forums as part of their compliance activities. The international forums, in particular those within the OECD, have played a significant role in concentrating efforts and creating a dialogue around tax havens in a global context. The Tax Office aims to leverage from the international dialogue to develop its own strategies and courses of action. This includes entering into TIEAs with cooperative tax havens. Australia has concluded agreements with three countries to date. The Tax Office is actively negotiating agreements with seven other countries and the Isle of Man has agreed to sign an agreement with Australia. The ANAO notes the advanced progress the Tax Office has made in negotiating agreements in comparison to other OECD nations. Australia is second only to the United States of America in the number of agreements negotiated and has actively pursued agreements with every declared non-OECD participating partner tax haven.

**35.** Recording and analysing the outcomes of active compliance and non-audit compliance activities is important to inform future planning and targeting of compliance risks. The Tax Office has set a range of effectiveness measures surrounding tax haven compliance activities. The ANAO found the method of measurement did not necessarily inform the extent of success; there was often no direct link between the measurement and the key outcome. The Tax Office also did not consistently set benchmarks or estimates of what success looks like in their business case or program plan. The ANAO notes the difficulty encountered by the Tax Office in measuring their success given the 'unknown factor' of tax haven compliance risks. Nevertheless, the ANAO considers there should be greater alignment between the Tax Office's performance effectiveness measures and the current strategies. This would assist the Tax Office's ability to assess the effectiveness of their treatment strategies over time.

## Summary of agency response

**36.** The Tax Office welcomes the Australian National Audit Office's (ANAO) recommendations in relation to its strategies to address tax haven compliance risks.

**37.** The concealment of assets and income in tax havens in an attempt to put them beyond our scrutiny is an ongoing challenge for the Tax Office. As the report acknowledges, the Tax Office is well regarded by the Organisation for Economic Cooperation and Development (OECD) and its member nations for its innovative strategies and activities in dealing with tax haven compliance risks.

**38.** The audit did not cover the full spectrum of our tax haven work including Project Wickenby and the joint work we are doing with other countries on emerging schemes. However, the report acknowledges that our response to tax haven work has included a range of risk treatment strategies including audit work, prosecutions, treaty negotiations, voluntary disclosure initiatives, leveraging off international experience and an increased focus on marketing and education.

**39.** It is encouraging to note the ANAO found that the Tax Office has adopted a sound risk management framework for tax haven compliance risks and has in place appropriate strategies in relation to tax haven compliance risk identification and assessment. In addition, the report specifically acknowledges that the framework has been adjusted to provide enhanced governance and appropriate focus on the risk and whole of Tax Office co-ordination at both formal and informal levels.

**40.** As noted in the report the Tax Office is the only tax administration within the OECD to have a publically available strategy document regarding tax haven compliance issues, in the form of its *Tax haven and tax administration* publication. The report further notes the advanced progress the Tax Office has made in negotiating Tax Information Exchange Agreements in comparison to other OECD countries and acknowledges that the Tax Office has been able to bring the experiences of exchanging tax information under a tax treaty to the negotiation of a TIEA.

**41.** The Tax Office's full response can be found in Appendix 1.

# Recommendations

**Recommendation No.1**

**Para 2.13**

The ANAO recommends that, to improve its organisational leadership and strategic direction on tax haven matters, the Tax Office's Tax Haven Steering Committee performs its roles and responsibilities on an ongoing basis as set out in its charter.

**Tax Office Response:** *Agreed.*

**Recommendation No.2**

**Para 3.39**

The ANAO recommends that the Tax Office improve its assessment of the extent of the tax haven compliance risks through greater trend analysis of qualitative and quantitative data.

**Tax Office Response:** *Agreed.*

**Recommendation No.3**

**Para 4.33**

The ANAO recommends that, following the first annual cycle of the current performance effectiveness measures, the Tax Office tests, reviews and where appropriate amends the performance measures relating to their compliance strategies for tax haven compliance risks.

**Tax Office Response:** *Agreed.*

# Audit Findings and Conclusions

# 1. Background and Context

*This Chapter provides a description of tax havens and an overview of the Australian Tax Office's strategies to deal with them. It also provides information on the conduct of the audit.*

## The Australian Taxation Office

**1.1** The Australian Taxation Office (Tax Office) is Australia's principal revenue collection agency, collecting around 90% of Commonwealth revenue. The Tax Office seeks to optimise voluntary compliance and make payments under the law in a way that builds community confidence. In 2006–07 the Tax Office collected $254.8 billion in tax, superannuation and excise revenue, and had an operating expenditure of $2 600 million. As at June 2007 it employed 22 342 employees.

## Tax havens in context

**1.2** Australian resident taxpayers are subject to tax on their worldwide income. Accordingly, Australia's taxation system of self assessment places a responsibility on taxpayers to declare all of their assessable income and claim only deductions and/or offsets to which they are entitled.

**1.3** Australia is part of a dynamic global economy that presents a variety of opportunities for individuals and businesses of all sizes to more easily trade offshore with countries that can have very different financial and legal systems to that of Australia.[7] Tax havens seek to attract international trade and investment by establishing financial, legal and tax systems that may be beneficial to some activities. Modern communication methods and the internet have made it easier for financial services to be provided from previously remote locations. The Tax Office's analysis of Australian Transaction Reports and Analysis Centre (AUSTRAC) data reveals that most direct transactions between Australia and tax havens are lawful international dealings and not attempts to evade tax payable in Australia.

**1.4** The systems that make tax havens attractive for legitimate purposes may also be used in arrangements designed to evade paying tax elsewhere, or for other criminal pursuits. There are also some particular tax haven

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7 References in this Report to 'countries' should be taken to apply equally to 'territories', 'dependencies' or 'jurisdictions'.

jurisdictions that make it easier to facilitate certain structures or arrangements, due to features of their corporate and banking regulatory systems. Some people and entities try to exploit these systems to evade Australian tax. The very nature of these transactions means that no revenue authority will ever be likely to comprehensively eliminate the issue. It is these transactions that the Tax Office targets in relation to its risk assessment and compliance activities in respect of tax havens and is the focus of this audit.

**1.5** The Tax Office defines a tax haven based on three key factors:

- it imposes **no or nominal taxes** and can be used by non-residents to escape tax in their country of residence;
- there is a **lack of effective exchange of information** with outside tax authorities based on strict secrecy rules and other protections; and
- there is a **lack of transparency** in the operation of its legislative, legal or administrative provisions, making it difficult, if not impossible, for other tax authorities to apply their laws effectively and fairly.

These criteria are based on the definition used by the Organisation for Economic Cooperation and Development (OECD), of which Australia is a member.

**1.6** Tax Information Exchange Agreements (TIEAs) are used by OECD countries to assist in overcoming the lack of access to specific transactional information in countries considered to be tax havens. When Australia enters into a TIEA with a tax haven, the Tax Office no longer identifies that country as a tax haven.

**1.7** Of the 32 Tax Office identified tax havens, 29 of these have become 'non-OECD participating partners' and have committed to eliminating harmful tax practices through transparency and effective information exchange. The three remaining tax havens have not made such a commitment. Table 1.1 lists the Tax Office identified tax havens and also identifies seven other countries Australia is in the process of a negotiating a TIEA with. Appendix 2 provides a comparison of the OECD and Tax Office lists.

## Table 1.1

### Tax Office identified tax havens

| Tax Office identified tax havens | | | |
|---|---|---|---|
| Andorra[1] | Cyprus | Mauritius | St Kitts & Nevis |
| Anguilla[2] | Dominica | Monaco[1] | St Lucia |
| Aruba[2] | Gibraltar | Montserrat | St Vincent & Grenadines |
| Bahamas | Grenada[2] | Nauru[2] | Turks & Caicos Islands |
| Bahrain | Guernsey[2] | Niue | Vanuatu |
| Belize | Jersey[2] | Panama | |
| British Virgin Islands[2] | Liberia | Samoa | |
| Cayman Islands | Liechtenstein[1] | San Marino | |
| Cook Islands | Marshall Islands | Seychelles | |

Note: [1] These tax havens have not yet committed to transparency and effective exchange of information.

[2] Countries Australia is currently in the process of negotiating a TIEA.

Source: Tax Office, *Tax Haven and Tax Administration*, Oct 2007, p. 8 and Tax Office internal documents.

**1.8** The Tax Office for the last several years has identified international tax risks, with a specific focus on tax havens, as being a 'headline issue' warranting increased compliance activities.[8] Minimising the illegal use of tax havens by Australian taxpayers is important for the Tax Office to ensure:

- community confidence in, and voluntary compliance with, Australia's tax system is not eroded through a perception that the Tax Office is unable to appropriately address the behaviour; and
- significant revenue is not lost.

**1.9** The 'tax haven' focus of the Tax Office is not exclusively concerned with activities associated with tax havens identified by the criteria above. Some countries that are not low-tax jurisdictions have bank secrecy arrangements that may be exploited to conceal income and evade tax because they do not have effective tax information exchange with Australia. The Tax Office as a consequence has an ongoing watch not only on tax havens, but also on established and emerging offshore financial centres otherwise known as

[8] Tax Office, *Compliance Programs* 2001–02 – 2007–08.

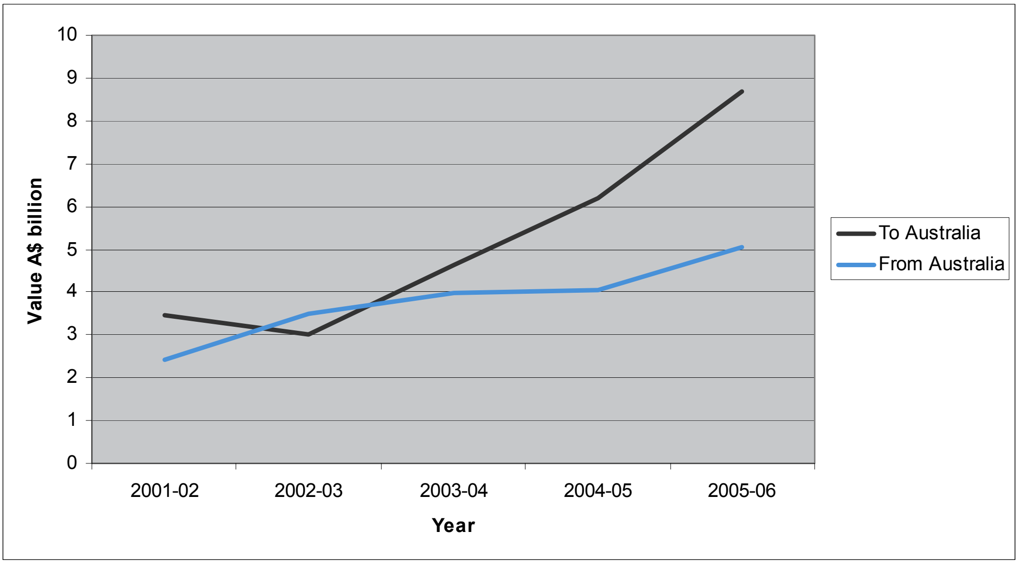
'*preferential regimes*'. The Tax Office refers to their compliance activity as focused on 'abusive offshore arrangements'. [9]

**1.10** The flow of Australian funds to and from tax havens provides useful trend information about the extent of activity. This information is sourced from the AUSTRAC which collects data from cash dealers in the form of Financial Transaction Reports (FTRs). The Tax Office's analysis of AUSTRAC data reveals that most direct transactions between Australia and tax havens are lawful international dealings and do not represent an attempt to evade tax payable in Australia. Transfers to Tax Office declared tax havens in 2005–06 was some A$5.0 billion, while total transfers to all other countries was A$1 414.4 billion (representing only 0.4% of all transfers from Australia). These figures do not necessarily capture the entirety of Australia's dealings with tax havens as funds may flow through other countries before they arrive in a tax haven. However, certain 'indirect' transfers are captured through advanced searching techniques employed by AUSTRAC. The Tax Office analysis of AUSTRAC data shows that from 2001–02 to 2005–06 total direct transfers to and from tax havens has increased from A$5.8 billon to A$13.7 billion, an increase of more than 230% over the five year period. Figure 1.1 shows the overall increasing trend of funds transferred between Australia and tax havens.

[9] Tax Office, *Tax havens and tax administration*, October, 2007, p 3. Note that while the focus of this audit was on the Tax Office's strategies to address tax haven compliance risks, as a result of the approach of the Tax Office, the audit focus extended beyond defined 'tax havens' to include 'abusive offshore arrangements'. References in this report to the Tax Office's strategies to address 'tax haven' compliance risks should be taken to apply equally to the Tax Office's strategies to address 'abusive offshore arrangements' compliance risks.

## Figure 1.1

### Funds to and from Tax Office identified tax havens




Source: ANAO analysis of Tax Office data.

**1.11** The flow of transfers to other countries with preferential tax regimes, further informs the extent of activity. In 2005–06 total value of transfers to preferential regimes was some A$191 billion and transfers from preferential regimes some A$159 billion. It is noted that some of these countries are included in the Department of Foreign Affairs and Trade's analysis of some of Australia's major merchandise trading partners.[10]

**1.12** The number of transfers to and from tax havens has also increased substantially over recent years. Figure 1.2 shows the steady growth in the number of transactions for the last five years. The number of transfers and flow of funds from Australia's major trading partners has also increased in the current decade.[11] However, there has been a disproportionate increase in activity with tax havens, over the five year period to 2005–06; the increase in the number of transfers from major trading partners has been 26%, whereas the increase in transfers from tax havens has been 65%. The increase is partly representative of growth in offshore financial centres internationally in the last decade. The ANAO considers the Tax Office should continue to focus on this particular measure as a potential way of tracking the impact of TIEAs and tax

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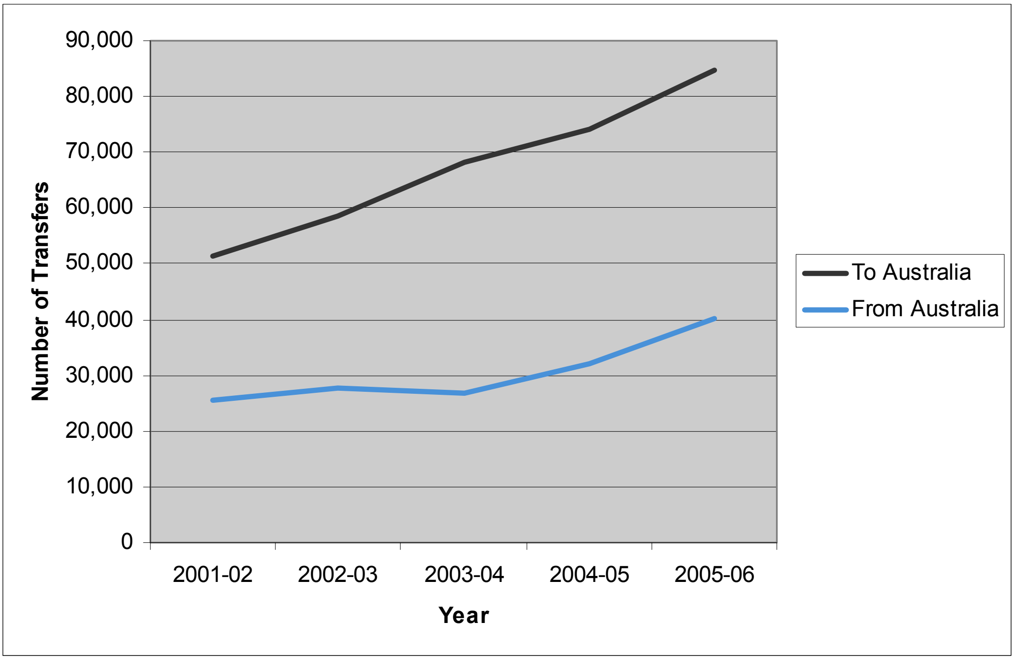
[10] Department of Foreign Affairs and Trade, *Composition of Trade Australia 2006-07*, November 2007.

[11] This includes the United States of America, the United Kingdom, New Zealand and Japan.

haven specific compliance activities, especially as the Tax Office improves its ability at distinguishing between illegitimate and legitimate transactions at the aggregate level which can be used for trend analysis and risk identification.

### Figure 1.2

**Number of transfers to and from Tax Office identified tax havens**




Source: ANAO analysis of Tax Office data.

## The use of tax havens

**1.13** Tax havens can be utilized in numerous ways for legitimate and illegitimate purposes. A common thread with the illegitimate use of particular tax haven systems is to conceal income and assets. The following case study provides some specific examples of how tax havens have been used, based on Tax Office experience. The range of activities noted below highlights the varying degrees of complexity or simplicity employed. This is also an evolving list where new schemes emerge or boutique arrangements are designed to replace schemes that are identified and mitigated against or closed off.

**Case studies**

Concealed assets and income

- Several highly wealthy individuals (HWIs) anonymously traded in Australian and offshore assets and failed to declare the profits in their income tax returns. Evidence gathered indicated that they were using bank accounts in tax havens to conceal assets and income. The Tax Office issued amended tax assessments involving significant additional tax, and imposed significant penalties.

Failure to substantiate claims

- AUSTRAC identified large transfers of funds from a Guernsey bank account to a taxpayer and his associates. The taxpayer was not able to produce evidence to substantiate his claim that a large part of the funds originated from a substantial inheritance, nor could he provide bank statements and other information requested to substantiate his other claims. The funds were assessed as income and there were substantial penalties.

Accessing profits of a tax haven entity

- The taxpayer, then a non-resident, conducted an overseas business venture. The venture was sold and the proceeds were directed to an international business company in a tax haven. The taxpayer controlled the international business company. The taxpayer's ownership of the company was disguised by using offshore nominee companies provided by an international promoter. On his return to Australia, the taxpayer, now a resident, tried to remain outside the tax system. Due to the Tax Office's actions, it resulted in the taxpayer lodging tax returns and paying back taxes. The international business company acquired properties in Australia and some years later transferred one of the properties to the taxpayer at cost. In effect, some of the gains of the international business company – that is, the amount representing the increased value of the property – were distributed to the taxpayer when the property was transferred to him at cost. This was deemed to be a distribution benefit received by the taxpayer and assessments were issued with interest and penalties.

Diversion of sales proceeds

- An Australian company was identified by the Tax Office as remitting funds to a Vanuatu company. The Australian company indicated that the funds had been received in error from other overseas companies and were therefore redirected to the Vanuatu company. Analysis of AUSTRAC information showed money was being transferred from Vanuatu to the personal account of the director of the Australian company. The director claimed to be a non-resident. Assessments were raised both on the company to include the omitted sales income and on the director. Substantial penalties of over 50% of the tax avoided were applied in this case.

Diversion of income offshore

- In response to a letter from the Tax Office about funds sent offshore, a taxpayer indicated that monies sent to Vanuatu represented the net proceeds of stock options, which the taxpayer had received from an employee stock option plan. These funds were deposited into a Vanuatu bank account. The taxpayer was assessed by the Tax Office on the profit and interest earned on the bank account with interest and penalties applied.

Round-robin transactions

- The Tax Office identified a large number of transactions between Australian taxpayers and certain bank accounts in another country that was not a tax haven. Tax Office analysis revealed that the international companies involved were all linked by partners in an accounting firm that was also an offshore service provider and based in a tax haven. The international companies and bank accounts were part of an elaborate arrangement to shift funds offshore and create false tax deductions in Australia then repatriate the same funds to Australia in a 'tax-free' guise.

Source: Tax Office, *Tax havens and tax administration*, October, 2007.

## Administration of the tax haven risk

**1.14** The Tax Office is not solely responsible for addressing tax haven compliance issues in Australia. The Australian Crime Commission, the Australian Federal Police and the Commonwealth Director of Public Prosecutions share responsibility for litigating abusive tax haven related schemes. At a government level, the Treasurer with assistance from the Department of the Treasury (Treasury) is responsible for initiating changes to tax legislation, and for negotiating tax treaties that protect Australia's right to tax international transactions.

**1.15** The Tax Office, as Australia's principal revenue agency, has responsibility for administering Australia's revenue system under the law. For tax haven and all tax compliance risks, that Tax Office relies at base on taxpayers having the right information and support to ensure voluntary compliance. Within the Tax Office responsibility for managing tax haven compliance risks is shared across numerous business lines and executive forums with differing responsibilities and accountabilities—see *Chapter 2—Management Arrangements*.

## The Tax Office's compliance approach

**1.16** The Tax Office's business model includes a compliance program which outlines the approach taken to encourage high levels of voluntary compliance with the law. The compliance risk model seeks to allocate compliance resources to areas identified as having the highest risk. The Tax Office's approach to tax haven compliance issues involves:

- ensuring taxpayers have the information and support they need to comply with their international tax obligations;
- collecting, exchanging and analysing information to identify practices and trends that pose a significant risk to compliance;
- monitoring and, where necessary, reviewing compliance;
- taking firm action where taxpayers deliberately or persistently fail to comply;
- advising Treasury if the current legislation may result in abusive or non-compliant tax avoidance;
- the negotiation of TIEAs with tax haven countries; and

- international cooperation with a number of countries working together in line with the OECD's Forum on Tax Administration's September 2006 meeting in Seoul, South Korea.[12]

**1.17** To provide taxpayers with certainty about the tax treatment of their affairs, the Tax Office encourages them to seek their advice, and publishes public rulings on international tax issues. The Tax Office also provides targeted information and tools through printed publications, telephone enquiry services and the Tax Office website.

**1.18** The Tax Office collects and analyses data on international transactions to verify compliance and identify aggressive international tax avoidance practices. In particular, it uses reports from AUSTRAC to:

- profile geographical areas;
- identify potentially high-risk transactions;
- identify and quantify compliance risks; and
- select cases for further investigation.

**1.19** Ensuring tax payer compliance in respect of tax havens is challenging; in general the extent of the tax avoidance risk is difficult to determine due to concealment and the lack of transparency in particular tax haven jurisdictions. The nature of the risk is also constantly changing as taxpayers and their advisers become more sophisticated and knowledgeable in their approach to tax compliance. The Tax Office is not able to rely on traditional compliance activities alone to mitigate tax evasion through the use of tax havens. Consequently the Tax Office has embraced a range of non-traditional treatment strategies including treaty negotiation and engaging in constant dialogue with its peer organisations overseas and relevant international forums.

## Audit objective and scope

### Audit objective

**1.20** The objective of the audit was to assess the Tax Office's strategies to address tax haven compliance risks. Particular emphasis was given to the Tax Office's:

- management arrangements relating to the administration of tax haven compliance risks;

12 See further the Final Seoul Declaration << http://www.oecd.org/dataoecd/38/29/37415572.pdf>>.

- risk management framework for the identification and evaluation of compliance risks, specifically the activities of the Offshore Compliance Program (OCP); and
- risk mitigation strategies.

## Audit scope

**1.21** The activities of the Aggressive Tax Planning (ATP) business line that has responsibility for identification, risk assessment and active compliance activities covering promoters in civil cases, were outside the scope of this audit. The audit also did not specifically focus on Project Wickenby which was formed to investigate a suspected case of widespread, systematic tax evasion, including the criminal use of tax havens. The audit did however cover the linkages and learnings made available through ATP and Project Wickenby to other areas within the Tax Office.

**1.22** In February 2008, details of individual customer's account information from a Liechtenstein based bank (an OECD and Tax Office identified tax haven) that was being used for tax avoidance and evasion were made available to various tax administrations, including Australia. This issue related to the criminal use of tax havens and was not examined during this audit.

## Audit methodology

**1.23** The audit included interviews with Tax Office business line staff, primarily from the OCP. Fieldwork also involved interviews with staff from the following business lines: ATP, Serious Non-Compliance (SNC), Micro Enterprises and Individuals; Small and Medium Enterprises; and the Chief Knowledge Officer. The ANAO also reviewed relevant Tax Office program and project files, and relevant strategic documents and business plans. The ANAO held meetings with the Treasury and AUSTRAC and consulted with key private sector stakeholders, other national revenue bodies, and international bodies including the OECD.

**1.24** This audit was undertaken in conformance with ANAO auditing standards and cost $320 000.

## Acknowledgements

**1.25** The ANAO would like to thank the Tax Office staff who assisted with the conduct of the audit, for their time, effort and expertise. The ANAO also appreciates the co-operation and assistance provided by private sector stakeholders and international bodies, including the OECD, consulted during the audit.

# 2. Management Arrangements

*This Chapter discusses the Tax Office's management arrangements supporting administration of tax haven compliance risks.*

## Introduction

**2.1** Development and implementation of sound governance arrangements supports the effective management of agencies' programs and service delivery. The principles of governance in the public sector are discussed in detail in the ANAO Better Practice Guide, *Public Sector Governance*, July 2003, which notes that:

> Broadly speaking, 'corporate governance' refers to the processes by which organisations are directed, controlled and held to account. It encompasses authority, accountability, stewardship, leadership, direction and control exercised in the organisation. [13]

**2.2** The tax haven compliance risk manifests itself across numerous business lines within the Tax Office. The Tax Haven Steering Committee (THSC) has the leadership and governance responsibility for tax haven compliance risks. The OCP—a section that employs 55 staff—within the Large Business and International business line supports the THSC in this endeavour.

**2.3** To assess the effectiveness of the Tax Office's management arrangements supporting the administration of tax haven compliance risks, the ANAO examined three key management issues:

- the organisational arrangements for administering tax haven compliance risks;
- planning processes; and
- performance monitoring and reporting.

## Organisational arrangements

**2.4** The Tax Office is a large organisation consisting of 22 342 staff as at 30 June 2007. To administer the taxation system and effectively address business and compliance risks, the Tax Office has adopted a matrix management model. The model combines the key elements of the Tax Office's management and

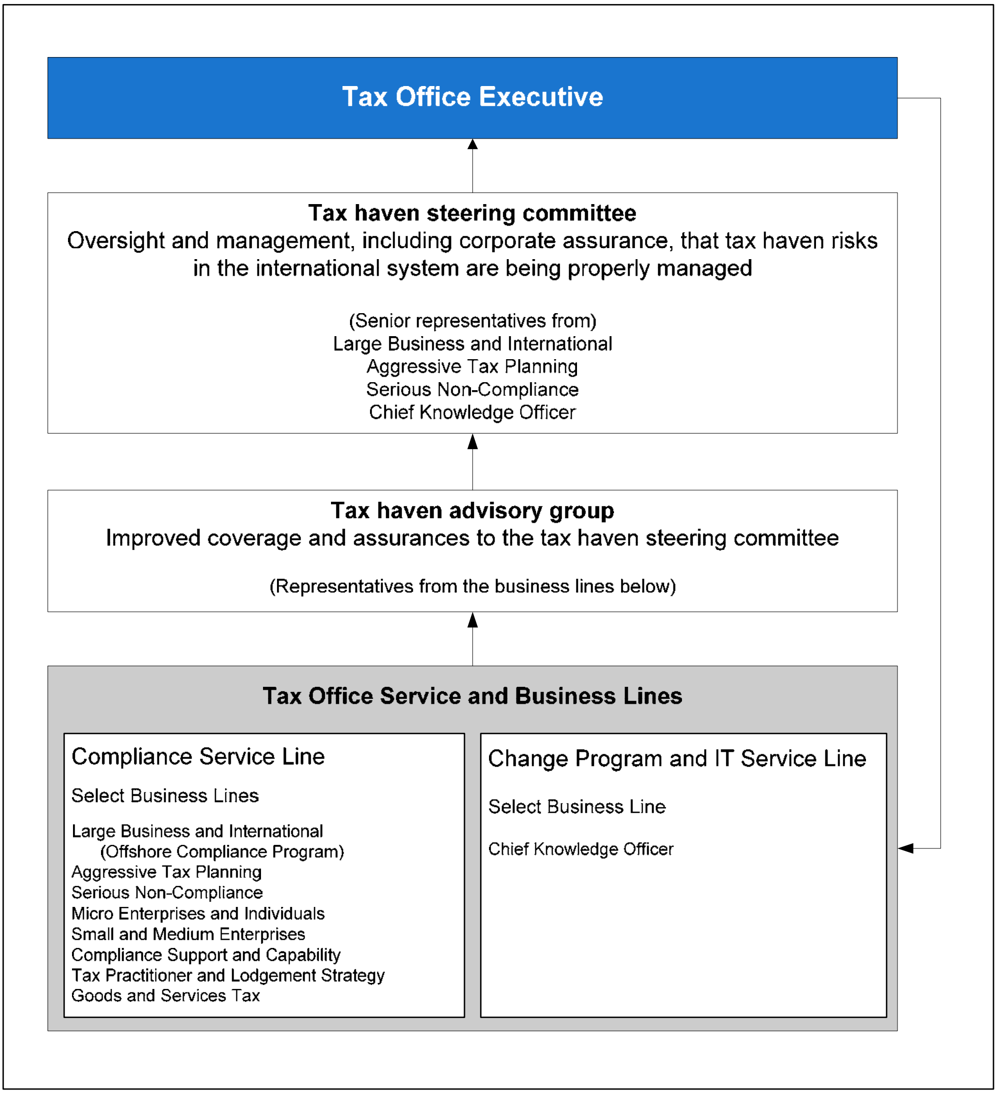
[13] ANAO, Better Practice Guide, *Public Sector Governance*, July, 2003.

planning frameworks. As part of its management framework the Tax Office classifies market segments and special focus areas to assist with risk identification, and organisational and business planning. The business and service lines are responsible for achieving the Tax Office's output and outcome commitments to Government.

**2.5** Responsibility for managing tax haven compliance risks is shared across numerous business lines of the Tax Office. Figure 2.1 summarises the Tax Office's organisational framework relevant to the administration of tax haven compliance risks.

## Figure 2.1

### Abridged Tax Office organisational structure highlighting areas relevant to the administration of tax haven compliance risks




Source: ANAO analysis of Tax Office information

## Role of the business lines

**2.6** Each business line has specific responsibilities discussed below:

- Large Business and International, specifically the OCP—marketing and education (jointly); active compliance activities on individuals; risk identification and intelligence research; leadership and governance; capability building; internal liaison; and policy improvement (jointly);
- Aggressive Tax Planning—identification, risk assessment and active compliance activities on promoters (civil cases);
- Serious Non-Compliance—identification, risk assessment and active compliance activities on tax payers and promoters within the criminal area; prosecutions; whole of government activities; and Project Wickenby; and
- Individual Business Lines—identification, risk assessment and active compliance activities on participants (including lodgement compliance).

## Role of the Tax Haven Steering Committee

**2.7** The THSC was set up in 2007 to be the main strategic body providing leadership and direction on tax haven matters to all relevant Tax Office areas. The fact that tax haven compliance risks emerges and is managed in some form across numerous business lines highlights the need for a strategic oversight body to provide coordinated guidance. The current body is an enhancement of a pre-existing THSC that had a more operational focus. Establishment of the enhanced THSC was first proposed in the original business case for the OCP in December 2006. The role of the THSC is to provide enhanced governance and appropriate focus on the risk and whole of Tax Office co-ordination.

**2.8** Reflecting the higher level strategic focus of the THSC, its members comprise a number of senior Tax Office executives. A draft charter was developed in March 2007 and endorsed in June 2007 which included the proposed frequency of meetings, roles and responsibilities and terms of reference. The charter also further emphasised the THSC's role as 'providing strategic leadership and direction on tax haven matters to relevant Tax Office areas'.[14] The Tax Office advised, however, that as of December 2007 the THSC had met only once. Under the charter the THSC is supposed to meet monthly.

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14 Tax Office internal document.

In all Tax Office documentation surrounding the governance of tax haven compliance risks, the THSC is noted as being central to the ongoing governance and strategic directions setting. The ANAO found that the THSC was not executing its roles and responsibilities as set out in its charter, thus not providing the expected high level co-ordination for the Tax Office's approach to managing the identified key tax haven compliance risks. The ANAO notes that as at November 2007 the Tax Office was in the process of a rollout of numerous new initiatives and advised that members of the THSC have met informally and through a variety of other executive forums after the first meeting to keep track of emerging issues.

**2.9** A robust framework for the strategic direction setting and project assessment of tax haven compliance activities at a whole of Tax Office level is an important governance mechanism to ensure the Tax Office is obtaining value for money and assurance from its compliance activities. As discussed in the ANAO Better Practice Guide *Public Sector Governance*, 'The primary function of internal accountability arrangements is to ensure clarity of roles and responsibilities and clarity of communications about decisions.'[15] Acknowledging the increased activity and focus of tax haven compliance activities, the ANAO considers that the THSC should be executing its charter responsibilities to ensure there is clarity and accountability surrounding the assessment and strategic direction setting relating to tax haven compliance risks.

**2.10** Notwithstanding that the Tax Office has increased its focus on management arrangements relating to tax haven compliance risks, the lack of oversight by the THSC meant the ANAO was unable to fully assess the effectiveness of the current arrangements.

**2.11** The nature of tax haven compliance risks differs from other compliance risks faced by the Tax Office. Their ability to access information from overseas jurisdictions, when compounded by the intentional concealment of that information, presents a challenging and very different scenario to Australian based compliance risks. Such a situation lends itself to the involvement or engagement of parties with wide international experience to inform the THSC in its role in identifying and assessing potential risks relating to illegitimate tax haven activity. Such consultation may stimulate different or new 'breakthrough' mitigation treatments to address the risks.

[15] ANAO, *op cit.*, p. 16.

**2.12** The ANAO notes the Tax Office has previously used external persons to review and drive strategic change within particular business lines—for example, the Sherman report into private binding rulings which had a major impact on the SNC business line.

## Recommendation No.1

**2.13** The ANAO recommends that, to improve its organisational leadership and strategic direction on tax haven matters, the Tax Office's Tax Haven Steering Committee performs its roles and responsibilities on an ongoing basis as set out in its charter.

**2.14** **Tax Office Response**: *Agreed*. The Tax Haven Steering Committee (THSC) has been operating on an informal basis with a focus on establishing the broad strategy and resources to manage the tax haven risk. The THSC members have also met as part of other Tax Office governance processes, for example Plenary Governance Forum and the Income Tax Steering Committee. We accept the need to formalise these arrangements. The Tax Office has now in place a three tiered interlocking governance structure to guide and support its tax haven strategy at the strategic and operational level. This includes the THSC, the Tax Haven Advisory Group and the Tax Haven Community of Practice. These arrangements are in addition to the sound governance and risk management arrangements that operate at business line, corporate and cross agency level.

### Role of the Tax Haven Advisory Group

**2.15** The Tax Haven Advisory Group (THAG) evolved following the creation of the THSC. The THAG is the main operationally based forum covering tax haven compliance risks, with responsibilities incorporating monitoring and reporting on tax haven risks, active compliance case work and compliance program outcomes across all affected business lines. The group is also used as an information sharing forum. The information sharing aspect is an important mechanism for intra Tax Office intelligence sharing reflecting its more operational focus. The THAG is comprised of line managers, has approved terms of reference and has met regularly.

## Planning processes

**2.16** A sound organisational planning framework is an essential element of effective management and governance. The Tax Office's high level planning documents, such as the sub plans and strategic statement, set the overall direction for the organisation. Tax haven compliance activities are administered as part of the Tax Office's Compliance Sub Plan.

**2.17** A risk assessment model referred to as the Health of the System Assessment (HOTSA) supports the Tax Office's planning framework. HOTSAs consider risks from both a Tax Office product and market segment perspective. In use within all business lines of the Tax Office, the HOTSA is a key input into the Tax Office's strategic planning framework. Risk assessments, which are the foundation of the HOTSA, provide the basis for identification of priorities and subsequent resource allocation. The Tax Office aims, through the HOTSA process, to identify and rate its compliance risks and develop strategies to mitigate those risks. The Tax Office has identified tax havens as a risk area through the HOTSA process in each of the last five years.

**2.18** To determine if the Tax Office has an integrated approach to planning for tax haven compliance risks, the ANAO analysed the links between the Compliance Sub Plan and lower level business line, team planning and individual staff planning documents. This analysis showed that the Tax Office's planning documents reflect the risks associated with tax haven compliance risks and are clearly linked and cross referenced to particular outputs. The business lines' delivery plans identified the particular initiatives and program of work, while the team and individual plans reflect their overall responsibilities and areas for improved performance.

## Performance monitoring and reporting

**2.19** Performance management underpins sound management and governance. Ongoing and regular monitoring and reporting of performance supports agencies in managing programs and in meeting external accountabilities to the Government and to the Parliament. The timely collection, and regular analysis and reporting of relevant performance information, assists in more effective decisions about the ongoing resourcing and impact of the tax haven compliance activities.

### Internal performance monitoring and reporting

**2.20** Tax haven compliance activities are reported and monitored internally at several levels. Many of the reporting requirements are part of the Tax Office wide reporting framework. These include the annual HOTSA process, a monthly 'Pulse' report and where relevant a weekly heartbeat report. In addition to the Tax Office wide reporting, the specific initiatives associated with tax haven compliance activities are reported to the THAG.

**2.21** The ANAO observed that the internal reporting generally aligned with the Tax Office wide reporting structure and provided a framework to support the ongoing management of tax haven compliance risks. As discussed previously there has been a lack of regular meetings of and reporting by the THSC. The ANAO considers a more active THSC would be able to better utilise the reporting framework for informed decision making and project assessment at a whole of Tax Office level.

## External reporting of performance

**2.22** The Tax Office has responded to the increased public and parliamentary interest in tax haven related activities with regular external reporting of tax haven compliance activities. The Tax Office utilises a variety of forums to report on activities including their annual report, specific publications, media releases and speeches. In its annual report, the Tax Office has reported on the increased use of AUSTRAC data, negotiated TIEAs, and the number of audit and risk reviews undertaken. However, in part due to the previously dispersed nature of tax haven compliance activities, there is a lack of consistency in tracking tax haven compliance activities and results within the annual reports. With the increased focus and centralisation of tax haven compliance activities, the Tax Office could include a standardised set of performance indicators within their annual report to improve public accountability and transparency.

**2.23** The Tax Office's assessment and evaluation of compliance activities is discussed in further detail in *Chapter 4—Tax Haven Compliance Activities*.

# 3. Tax Haven Compliance Risks

*This Chapter considers the Tax Office's strategies to identify, analyse and evaluate tax haven compliance risks.*

## Introduction

**3.1** The compliance risks associated with the use of tax havens for the Tax Office and the community is that their illegitimate use adversely affects the revenue base and has the potential to affect confidence in the administration of the tax system. Treating tax haven compliance risks is particularly difficult; in general the extent of the tax avoidance risk is difficult to determine due to concealment and the lack of transparency in particular tax haven jurisdictions. The nature of the risk is also constantly changing as taxpayers and their advisers become more sophisticated and knowledgeable in their approach to tax compliance.

**3.2** Compliance risk management *is a structured process for the systematic identification, assessment, ranking and treatment of tax compliance risks.*[16] In this environment, the Tax Office's strategies to identify and assess risk across all its activities must be constantly evolving. The Tax Office should embrace a mix of strategies to analyse and evaluate tax haven compliance risks to ensure they achieve appropriate coverage of the changing issues that they face.

**3.3** In examining the Tax Office's approach to tax haven compliance risks we expected to see that the Tax Office has appropriate strategies to identify, analyse and evaluate tax haven compliance risks on an ongoing basis.

## Risk management framework

**3.4** The framework for tax haven compliance risk management in the Tax Office takes place within the context of Tax Office-wide risk management. The model that underpins the Tax Office's compliance risk management process is presented in Figure 3.1. This model is compatible with sound practice in risk management.[17]

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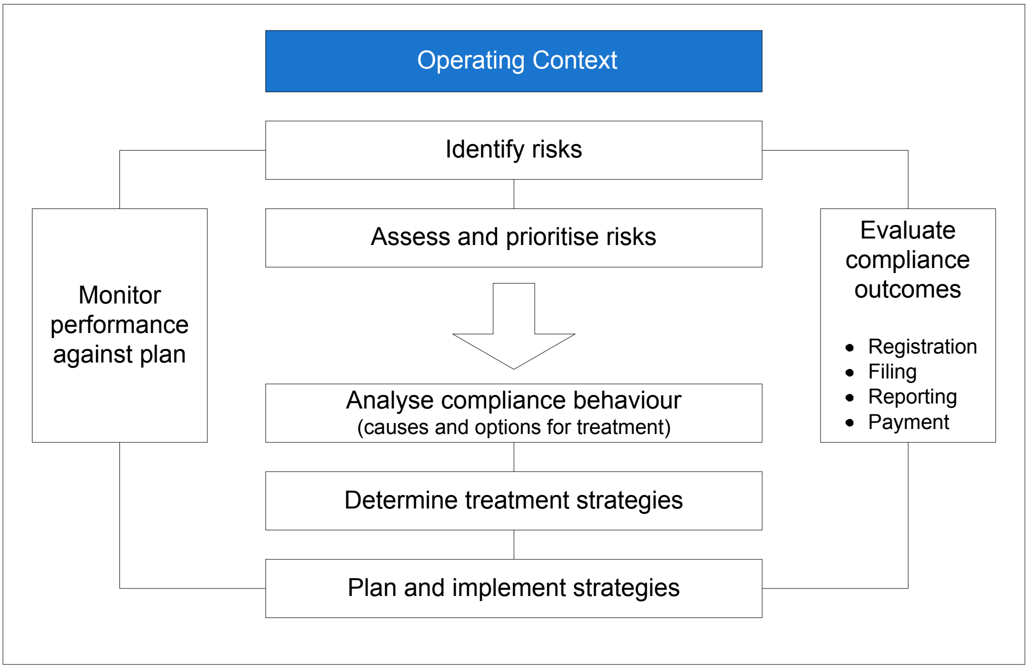
16 OECD, 2004. *Compliance Risk Management: Managing and Improving Tax Compliance,* Centre for Tax Policy and Administration Guidance Note, p. 8.

17 The model is compatible with Standards Australia, risk management standard AS/NZ 4360:2004, and the OECD's Compliance Risk Management Model.

## Figure 3.1

### The Tax Office's compliance risk model




Source: Tax Office, *Risk Management: Managing the Tax Office and Managing Compliance*. p. 29.

**3.5** The Tax Office's business model reflects the compliance risk model and seeks to allocate its compliance resources to areas identified as having the highest risk. In doing so the Tax Office aims to make informed choices about how it uses its resources. As mentioned earlier, the Tax Office business model is broadly structured around particular market segments and risk areas.

**3.6** The Tax Office publishes its *Compliance Program* annually. This program describes the Tax Office's overall approach to managing compliance, discusses the risks associated with Australia's revenue system, and how the Tax Office proposes to treat those risks. Within this program, the Tax Office identifies risks within particular market segments as well as headline issues for which the Tax Office identifies specific compliance risks and develops a general compliance approach. For the last six *Compliance Programs*, international tax risks, with a specific focus on tax havens has been identified as a headline issue warranting increased compliance activities.

**3.7** As discussed previously, tax haven compliance risks emerge in some form across numerous business lines. Corporate responsibility for managing the risk is held by the THSC. The THSC includes senior cross business line representation that aims to ensure enhanced and appropriate focus across the Tax Office. The newly formed OCP focuses on tax haven active compliance activities.[18]

**3.8** Sound management practice indicates that organisations should have documented risk management procedures and processes. This should include specification of the roles and responsibilities of the various groups involved in managing risks. As at November 2007, the THSC and OCP were undergoing significant change due to additional resources and enhanced responsibilities. The ANAO notes that within this reasonably short timeframe, the OCP developed a Risk Management and Action Plan, an Intelligence Plan, and had detailed roles and responsibilities for staff within the program.

## Tax haven risk identification

**3.9** Risk identification is highlighted by the Tax Office as one of the key elements of their multifaceted tax haven strategy. The broad approach of this strategy is to:

> Improve the whole of the Tax Office's understanding on the extent of the tax haven risk, in particular through Analytics, improved analysis of AUSTRAC data, debit/credit card data and exchange of information with treaty partners and internet searches.[19]

**3.10** Risk identification also plays a significant role in the understanding of the differing types of risk and the nature of the risk. The greater the understanding of the nature and extent of the risk, the greater the ability to direct appropriate resources for differing strategies. This section considers the activities undertaken by the Tax Office to inform their understanding of the compliance risks relating to tax havens. In particular, the ANAO examined the Tax Office's:

- use of AUSTRAC data;
- business line input;
- participation in international activities; and
- use of other intelligence sources.

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[18] This is primarily in the Medium Enterprise, Individuals and the bottom end of the small to medium enterprise markets.

[19] Tax Office, *Tax Haven Strategy*, December, 2006 p. 8. Analytics is a specialised information technology unit within the Office of the Chief Knowledge Officer with the Tax Office.

## AUSTRAC data

**3.11** AUSTRAC is Australia's financial intelligence unit and anti-money laundering and financial services industry regulator. AUSTRAC collects and compiles FTR information from cash dealers[20] and makes this available to partner agencies, including the Tax Office. FTR information (AUSTRAC data), is one of Tax Office's key intelligence sources for tax haven risk analysis.

**3.12** The Tax Office also uses on-line facilities to access the AUSTRAC system. This gives the Tax Office the ability to:

- view information reported to AUSTRAC;
- complete a range of searches; and
- download data for further analysis.

AUSTRAC also provides a range of other off-line financial intelligence services to the Tax Office, including customised analytical downloads.

**3.13** The Tax Office uses AUSTRAC data in a number of ways including:

- monitoring financial flows into and out of Australia;
- profiling geographical areas;
- identifying potential high risk transactions;
- identifying and quantifying compliance risks and developing compliance strategies; and
- assisting in the selection of compliance cases for further review or investigation.

**3.14** Using AUSTRAC data, the OCP produces a number of regular reports based on transaction activity to and from tax havens. These reports include yearly, monthly and exception reports that enable the OCP to monitor the general trends and to focus attention where warranted. For example, specific country reports are produced when there is intelligence that indicates heightened activity in that country.

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[20] Cash Dealers as defined in Section 3 of the *Financial Transaction Reports Act 1988* include: banks, building societies and credit unions (referred to as 'financial institutions'); financial corporations; insurance companies and insurance intermediaries; securities dealers and futures brokers; cash carriers; managers and trustees of unit trusts; firms that deal in travellers cheques, money orders and the like persons who collect, hold, exchange or remit currency on behalf of other persons; currency and bullion dealers; casinos and gambling houses; and totalisator agency board.

**3.15** AUSTRAC data is also used significantly in the research surrounding particular cases. Based on fields within the AUSTRAC data set, the OCP can do further searches on similar information. For example, where there is a series of transactions all from a particular postal address, these can be potentially linked together through the work of intelligence officers and proprietary software.

**3.16** The full utilisation of AUSTRAC data is restricted in part as it is not possible to undertake automated data matching of all AUSTRAC data against Tax Office client data. Following recent pilots, the Tax Office advised that it is possible to match approximately 47% of AUSTRAC tax haven transactions using Analytics—the 47% match rate is a significant improvement on previous exercises as AUSTRAC data does not contain a single taxpayer identifier, such as a Tax File Number. However even given this level of matching and the extent of the unmatched AUSTRAC transactions, to obtain meaningful information from AUSTRAC data requires significant resources and expertise on the part of the Tax Office.

**3.17** A pilot based on 2004–05 data was used by the Analytics team in consultation with the OCP with the aim that '….a more systematic approach to Tax Haven risk be conducted to estimate the risk posed by these financial destinations by making use of FTR data in particular.'[21] The results from this pilot are being viewed internally as 'very promising'. A number of further pilots are currently being undertaken and there have been a number of other opportunities identified where this approach could be used. Given the importance of AUSTRAC data in informing the tax haven risk, the ANAO considers that additional benefits may be achieved if further work is conducted between the OCP, AUSTRAC and Analytics to more systematically inform tax haven compliance risks.

## Business line input

**3.18** The intelligence from individual business lines assists significantly in understanding tax haven compliance risks for the Tax Office as a whole. The challenge for the Tax Office is its ability to access the intelligence in a coherent and coordinated manner. The Tax Office currently uses two primary methods of consolidating cross business line tax haven compliance intelligence; the THAG process and a less formal referral process for individual cases. Under a new general Tax Office case management system, there is further proposed

[21] Tax Office internal document.

integration between business lines. This system was not reviewed in detail as at November 2007 as it was in the initial stages of being implemented.

**3.19** As discussed in *Chapter 2—Management Arrangements*, the THAG committee includes representatives at line manager level from various business lines and forms the main operational based forum for business line information sharing. The meeting structure enables the sharing of information and updates on trends and emerging issues. The committee process was an effective mechanism for the OCP in its risk gathering activities.

**3.20** Informal referrals of information also provide significant intelligence to OCP. This may range between the actual hand over of case responsibility, to an email, or just a conversation. The ANAO noted there were very few controls over this informal referral process which makes it difficult to ensure that all relevant tax haven intelligence is provided to OCP. The ANAO considers that the intelligence gathering techniques of the OCP could be further improved by a more systematic and structured referral process to OCP for tax haven intelligence. The Tax Office advised the ANAO that the new case management system will in part address this issue.

**3.21** The transfer of intelligence both to and from the OCP may provide the Tax Office with future opportunities to identify non-compliance across a range of issues. The following case study highlights how another revenue authority identified more than just tax haven compliance issues when it embarked on a disclosure initiative.

**Case Study**

In the United Kingdom, Her Majesty's Revenue and Customs (HMRC) began its offshore disclosure regime in 2004 and a specific 'Offshore Disclosure Facility' (ODF) in 2007 inviting taxpayers with undeclared offshore assets and income the opportunity to disclose their details and thus incur access to reduced penalties and fines. The ODF was coupled with HMRC knowledge of the names, addresses and account transaction details of the offshore account holders from 5 of the UK's top banks and other financial institutions.

By November 2007, over 62 000 people had registered to make disclosures and £331 million had been banked, with a total projected yield of just over £400 million.

Based on a sample of the disclosures, HMRC undertook some further analysis on the taxpayers making disclosures to obtain a more complete profile of their behaviour. The further analysis revealed that if the taxpayer was involved in offshore tax evasion it was more likely that they would also be involved in some other form of non-compliant activity when compared to 'ordinary taxpayers'.

## Overseas participation

**3.22** Australia is a member of, and contributor to, a number of international forums that concentrate on tax issues, including:

- relevant OECD groups, in particular the Forum on Tax Administration[22];
- the Leeds Castle group;
- the seven-country working group on tax havens;
- the Joint International Tax Shelter Information Centre (JITSIC); and
- the financial action taskforce on money laundering.

**3.23** These groups have a variety of purposes, but all serve to better inform the Tax Office of both the nature and extent of the tax haven risk in a global context. These groups also facilitate the exchange of intelligence on individual and case bases where appropriate. The ANAO reviewed in detail the Tax Office's activities within the *Forum on Harmful Tax Practices* (the OECD Forum), a sub-group within the OECD, and also the seven-country working group on tax havens.

**3.24** The OECD Forum is structured around individual country updates and presentations. At its meeting in November 2007 the Tax Office presented a paper regarding the implementation of strategies to address tax haven compliance risks. The OECD also facilitates the formal and informal exchange of intelligence, including notification of emerging trends and schemes. The Tax Office is well regarded both within the OECD generally and by individual OECD nations for its innovative strategies and activities in dealing with tax haven compliance risks.

**3.25** The seven-country working group on tax havens is also another significant intelligence source for the Tax Office. The seven nations include Australia, Canada, Germany, France, Japan, the United Kingdom and the United States of America. The aim of the group is to increase cooperation and each country's capacity to deal with the tax haven risk. Members bilaterally exchange information at a case and promoter level, share research and information on tax avoidance and minimisation schemes encountered and strategies adopted. The Tax Office utilises the fact that there are significant

[22] See further the Final Seoul Declaration << http://www.oecd.org/dataoecd/38/29/37415572.pdf>>.

commonalties between the seven nations, and the size of the group allows for the quick flow of intelligence.

**3.26** The international activities of the Tax Office play a significant role in ensuring the Tax Office is abreast of new developments and intelligence regarding tax haven compliance issues. The Tax Office plays a positive role in its international participation that assists in protecting Australia's revenue base.

### Other intelligence sources

**3.27** The Tax Office also uses a variety of other more project based intelligence to inform itself of tax haven compliance risks including:

- a debit/credit project which identified a number of taxpayers who used debit/credit cards issued from tax havens;
- international information exchanges under Australia's treaties and TIEAs;
- tax returns;
- internet research; and
- information from the public.

**3.28** The very nature of tax haven compliance risks means that no revenue authority will ever be likely to comprehensively eliminate the issue. As described by the Tax Office it will always be a case of 'it's what we don't know that concerns us'.[23] The Tax Office has employed a variety of strategies to better inform itself of the nature and extent of the risk posed. The ANAO considers the Tax Office has appropriate strategies in relation to tax haven compliance risk identification and assessment, and that the enhanced and consolidated compliance activities should in the future provide a stronger basis for informed risk identification.

## Risk analysis and assessment

**3.29** Risk analysis is the process where the likelihood and consequences of the risk events are reviewed. This process acts as a precursor to setting risk priorities. Intelligence analysis assists the Tax Office in its decision-making; contributes to policy development; and enhances resource planning around aggressive tax planning. Failures in intelligence analysis may lead to the Tax

[23] Tax Office, *Tax Haven Strategy*, December, 2006, p. 11.

Office failing to identify tax haven compliance issues at an early stage, leading to inadequate monitoring and follow-up of risk assessments to rectify the problems. In managing tax haven compliance risks, intelligence analysis is important to 'make sense' of the tactical intelligence gathered to provide the Tax Office with a greater understanding of tax haven compliance issues.

**3.30** Since December 2003 the Tax Office has had a centralised intelligence unit to analyse and assess tax haven compliance risks. This unit contains specialised higher level staff that are engaged purely in risk analysis and assessment. As discussed in *Chapter 1—Background and Context*, since July 2007, the OCP has incorporated specific compliance staff that increased the team from approximately 17 primarily intelligence staff to 55 full time equivalents. On the 15th October 2007, the Government announced further expansion of the compliance program—$446 million over four years from 2008–09, including additional resources to the OCP.[24] As at November 2007, the Tax Office was still in the process of allocating the additional funds to business lines.

**3.31** The increased focus and resourcing of specific offshore compliance activities and dissemination of this information is a growing trend amongst comparable national revenue agencies. The following case study tracks the Canadian experience over recent years.

**Case Study**

In the 2005 Budget, the Canada Revenue Agency (CRA) received an additional CAD$30 million annually to strengthen its capacity to administer the tax system in areas where aggressive tax planning and compliance risks have the potential to erode the tax base. The funds were used to:

- establish 11 centres of expertise to strengthen and enhance its audit and collection programs to counter international avoidance and evasion and aggressive international tax planning;
- hire additional resources in international audit and tax avoidance to deal with international transactions;
- train employees on the latest developments in abusive international tax planning;
- work with other countries to detect abusive international tax schemes; and
- develop communications initiatives to inform taxpayers and tax planners about international tax arrangements that may contravene Canadian tax laws.

The CRA reported that this particular investment contributed to a spike in fiscal impact for 2006–07 and has used the investment to strengthen existing specialised audit groups to focus on aggressive international tax schemes, and enhance their ability to target entities and individuals who are promoting or participating in abusive tax schemes.

The CRA notes that the ongoing impact of the investment is uncertain for future years however they view the additional investment as having significant value in deterring reporting non-compliance.

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24 Following release of the *Mid-Year Economic and Fiscal Outlook 2007-08*, October, 2007.

3.32 Within the Tax Office it has been due to the existence of a centralised and dedicated unit that the specific typologies of tax haven compliance risks have been exposed. The nature of individual case based work would unlikely be able to pull together the entirety of all of a taxpayer's relationships. The ANAO observed instances where separate seemingly disparate pieces of intelligence were brought together to form a consolidated viewpoint, not only for individual taxpayers, but also for onshore and offshore promoters and intermediaries.

3.33 Flowing from the intelligence work of the OCP, cases are reviewed and are given to compliance staff for further work where appropriate. The OCP has established a National Case Selection Panel (NCSP) which is intended to serve as the body responsible to allocating the risk rating, recommending cases for further work and the tracking of case progress. This NCSP was in the early stages of formation as at November 2007 and was still in the process of finalising its precise role and responsibilities.

3.34 From an international perspective the establishment of a centralised unit for tax haven compliance risks is an emerging trend for OECD nations. Australia is currently one of only a few nations to have a centralised unit. While each nation adopts an approach that is complementary to their individual risk factors and tax office structure, the Tax Office's approach to centralising risk analysis and assessment for tax haven compliance risks is consistent with leading practice.

## Risk evaluation

### Nature and extent of risk

3.35 The setting of risk priorities is achieved through risk evaluation. Risk evaluation is the process used to determine risk management priorities by evaluating and comparing the level of risk against predetermined standards, target risk levels or other criteria. Risk evaluation within the tax haven compliance context as previously discussed is especially difficult as there is, and will always be, an unknown element to the risk environment.

3.36 The Tax Office uses a variety of criteria to evaluate the level of risk in relation to tax haven compliance including: materiality, seriousness, and likelihood of recurrence. The evaluation of risks must take place within the context of the nature and extent of the risk. Through analysis and past compliance, the Tax Office has gained an understanding of the nature of the risk. The OCP has also previously attempted to measure the extent of tax haven compliance risks. This historically based measure of the extent of the risk is still currently used in part for resource justification and risk work.

**3.37** The Tax Office has previously attempted to measure the extent of the risk at a broad level. While the historically based measurement was done with little detailed analysis, it is still currently used in part for resource justification and risk work. The Tax Office could improve its assessment of the extent of tax haven compliance risks through greater trend analysis of qualitative and quantitative data, particularly in the use and increased analysis of AUSTRAC data. This is particularly important as funds may be transferred in the first instance to a country which is not a tax haven. Any subsequent transfers are extremely difficult to monitor by the Tax Office.

**3.38** In the United Kingdom, the HMRC set specific targets in their recent ODF—see further case study at paragraph 3.21. Estimating the extent of the risk was achieved through the extrapolation of a known population to the wider community. While this method did not capture the entirety of the risk, and allowing for external variables, it did provide a baseline to measure and rationalise the extent of its success. In addition, the HMRC's ODF revealed a previously a undetected class of behaviour that further informed their ongoing strategies and initiatives.

## Recommendation No.2

**3.39** The ANAO recommends that the Tax Office improve its assessment of the extent of the tax haven compliance risks through greater trend analysis of qualitative and quantitative data.

**3.40** **Tax Office Response:** *Agreed*. The Tax Office, along with other tax administrations, is continuing to improve the understanding of the risks posed by the inappropriate use of tax havens. The Tax Office uses data from AUSTRAC to monitor transfers to and from tax havens. As the report indicates, our analysis of this data has shown that the majority of transactions with tax havens are legitimate reflecting the position that these jurisdictions have in the global financial system. It has proved to be difficult to get robust estimates of the extent of the tax risk. The use of intermediate destinations to transit transactions further complicates this process. The Tax Office will continue to reconcile high level flows to tax havens with specific analysis of transactions considered high risk to improve its view of the relative risk of various tax havens. This will also include working in partnership with AUSTRAC to further enhance our analytic capability.

# 4. Tax Haven Compliance Activities

*This Chapter discusses the treatment strategies undertaken by the Australian Taxation Office to mitigate tax haven compliance risks.*

## Introduction

**4.1** The Tax Office's overall aim for compliance is to achieve high levels of voluntary compliance. This is facilitated by a Compliance Program that: '…involves a mix of help and information (including helping taxpayers deal with us online at minimal cost and effort) and verification and enforcement activities (such as risk reviews, audits and prosecutions)'.[25]

**4.2** Within the context of the Tax Office compliance program the ANAO considered the Tax Office's treatment strategies in relation to tax haven compliance risks, and whether the associated activities were implemented and assessed in accordance with compliance plans. In particular the ANAO considered whether the Tax Office:

- uses an appropriate range of compliance products and processes to treat identified tax haven compliance risks;
- supports ongoing compliance activities with capability building for staff; and
- has appropriate processes for the evaluation and analysis of their compliance activities.

## Activities designed to assist compliance

**4.3** The Tax Office states that within their business model 'We make it as easy as possible to comply.'[26] To support this statement, the Tax Office produces a wide range of products and provides a number of services to assist people and entities in meeting their taxation obligations. The ANAO reviewed particular aspects of the Tax Office's compliance assistance in relation to the tax haven compliance risks, including their marketing and education.

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[25] Tax Office, *Compliance Program 2007–08*, p. 5.

[26] Tax Office, *Making it Easier to Comply 2007-08,* p. 4.

## Marketing and Education

**4.4** The broad approach of the marketing and education strategy is to:

> Optimise use of publicity channels to educate and inform the community of the risks of tax haven based arrangements and our progress in addressing risk, in particular through our active compliance activity (includes the Compliance Program, Taxpayers Alerts, media releases, speeches etc) and develop appropriate education products. Use tax agent communication and education channels to convey messages about haven risks and to encourage voluntary disclosure.[27]

**4.5** Achievement of the marketing and education strategy is partly dependant on successful compliance assistance products. The Tax Office classified assistance products into four category layers as detailed in Table 4.1.

### Table 4.1

### The four layers of compliance assistance products

| Layers | Description and Examples |
|---|---|
| 1. Awareness | These are simple, high-level introductory products, referring taxpayers to additional information. e.g. Editorials, media articles, speeches and flyers. |
| 2. Applicability | These provide more detail than Layer 1 products, help individuals identify their tax obligations, and reference additional information. |
| 3. Meet Obligations | Layer 3 products help taxpayers meet their obligations with respect to specific areas of tax haven compliance. |
| 4. Rules | These products provide detailed technical information to help taxpayers meet their obligations with respect to specific areas of tax haven transactions. |

Source: Tax Office.

**4.6** Understanding the effectiveness of particular communication activities assists the Tax Office in shaping and directing ongoing activities. To measure the effectiveness of compliance activities, the Tax Offices utilizes the Community Perceptions Survey (CPS) as a flagship survey to monitor the community's perception of the Tax Office over time, and this guides future initiatives. The 2006–07 survey saw an increased perception in many of the key measures on the CPS suggesting:

27 Tax Office internal document.

….that the community are now more engaged with the Australian Taxation Office (Tax Office) than at any other point in time in the past ten years and unanimously believe in the importance of the tax system.[28]

**4.7** In 2007, for the first time in the CPS, a direct question was asked about the effectiveness of the Tax Office in stopping people and businesses using tax havens to avoid paying tax. The responses to this question were contrary to the overall summary of the CPS which was positive. Community perceptions of the Tax Office efficacy in this area are weakest, compared to perceptions of enforcement of other compliance elements.'[29] This survey response highlights the particular challenges and difficulties the Tax Office has in addressing the community's perception surrounding tax haven compliance activities.

### *Products*

**4.8** The Tax Office has released a variety of tax haven compliance products across all layers of the compliance assistance table. The ANAO observed a substantial increase during 2007 in Layer 1 products including media releases and speeches that accompanied the release of particular compliance products surrounding tax haven activities.

**4.9** A key product of the Tax Office is the publication *Tax havens and tax administration*.[30] This is the second edition of the booklet that was first published in February 2004. The booklet: '…is designed to help people better understand their tax obligations when investing offshore and alerts them to the risks of getting involved in dodgy arrangements.'[31] The booklet is a comprehensive document covering the context of tax havens, the risks for taxpayers and promoters, and how the Tax Office deals with tax haven arrangements. This user friendly booklet contains many easy to follow examples and succinctly outlines people's tax obligations. The ANAO notes that within the OECD the Tax Office is alone as a revenue body having a publicly available strategy document regarding tax haven compliance issues. The booklet is a positive element of the broader education approach.

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[28] Tax Office, *Community Perceptions Survey 2007*, p. 7.

[29] *ibid.*, p. 125.

[30] Tax Office, *Tax havens and tax administration*, October 2007.

[31] Tax Office, *Media release: 2007/47* (October 2007).

**4.10** Some of the compliance assistance products produced to date have been developed in accordance with the *Tax Havens – Offshore bank account voluntary disclosure pilot Communication plan*.[32] The Tax Office advised the ANAO that it is still in the process of developing a communication for the OCP more generally. As at 1 February 2008 the Tax Office had developed a draft 'Tax avoidance and tax crime communication strategy' that seeks to provide an overarching coordinated and concerted focus to tax avoidance and tax crime communication. The effectiveness of the OCP communication strategies is contingent on a range of internal and external factors, some of which the Tax Office has little power to change or influence, such as other media events. Acknowledging the difficulty faced, the ANAO expected an integrated communication and marketing strategy to be in place that included a whole of Tax Office view and considered whole of government initiatives to mitigate any potentially adverse events. The ANAO considers, given the severity of the community's perception, the Tax Office should finalise their communication strategy for the tax haven risk.

## Active compliance

**4.11** The Tax Office has recently embarked on a range of active compliance activities following the implementation of the revised tax haven strategy and formation of the OCP. Many of the initiatives were in the rollout phase as at November 2007. This section provides an overview of the most recent initiatives undertaken by the Tax Office

### *The Offshore Voluntary Disclosure Initiative (OVDI)*

**4.12** The OVDI encourages people to come forward and make disclosures of previously undeclared income or assets from offshore activities. This is not an amnesty; it merely provides people with the opportunity to review their tax affairs and access reduced shortfall penalties. The OVDI is based on two successful exercises by overseas revenue agencies: Irish Revenue (Ireland) and HMRC (United Kingdom). Through international liaison and cooperation with these and other revenue authorities the Tax Office is leveraging from the relationships it has formed, and has tailored the approaches of these other administrations in rolling out the Australian OVDI.

[32] Tax Office internal document.

**4.13** The OVDI is primarily directed at known risk areas, and to facilitate the process the Tax Office has:

- asked the overseas subsidiaries or branches of some Australian financial institutions to write to their Australian customers in one particular tax haven, as a pilot, encouraging them to make a voluntary disclosure of unreported income, if required, to the Tax Office;
- sent over 1500 letters to taxpayers to 'prompt' them to review their affairs and if necessary become compliant;
- released the *Tax havens and tax administration booklet*; and
- given prominence to the initiative on the Tax Office website and in the Commissioner's speeches and media releases in 2007.

**4.14** As part of the OVDI, the Tax Office advised the ANAO as at May 2008, there had been $32 million in omitted income from 733 disclosures.

**4.15** The OVDI is heavily based on successful overseas initiatives. In these circumstances the overseas revenue offices had a clear compliance problem as the reason for embarking on the disclosure offer. The disclosure offer enabled the efficient processing of numerous cases without resource intensive audit work. The following case study provides a summary of the Irish experience.

**Case Study**

In 2002 Irish Revenue (Revenue) launched a program of action to address their tax haven compliance issues. They established an Offshore Asset Group (OAG), which focused on the use of offshore facilities by Irish resident taxpayers to evade tax.

In 2003 the Revenue Chairman initiated a series of meetings with chief executives of a number of financial institutions seeking their cooperation with a comprehensive enquiry into all offshore accounts. As a result of these meetings, the institutions concerned signalled that they would cooperate with the enquiry.

In 2004 Revenue announced that an investigation would be launched into holders of offshore accounts who had not previously declared underlying funds for tax purposes. Holders of offshore accounts were given a deadline to indicate whether or not they had a disclosure to make and a further deadline to forward payments and submissions. In total, €713.2 million had been collected at the end of 2004 as a result of the Revenue initiatives. In 2005, the OAG investigation continued to follow up on persons who did not make disclosures.

Since the program commenced in 2002, Revenue had processed 14,321 cases and it had raised €852 million (€389 in Tax and €462.6 in Interest and Penalties) from offshore accounts, as at 30 December 2006.

**4.16** The Tax Office operates in a very different geographical and economic environment, with a different rationale underpinning their tailored initiative. The Tax Office's rationale is that it is generally increasing its active compliance activities in this area and wanted to give taxpayers the opportunity to review their affairs beforehand and if required to become compliant. While overseas experience has shown that the initiatives can be successful not only for non-compliance in relation to tax havens but in other areas as well, the full utility of a disclosure initiative will always be negated by the fact that there are nations that continue to effectively position themselves to be tax havens and that some individuals will continue to pursue a position of non-disclosure.

### *Case work*

**4.17** The OVDI is complemented by an increased focus on case work by the OCP on profiled taxpayers who have been assessed as high risk. These cases have emerged from risk activates including a credit/debit card project and AUSTRAC analysis. The case selection processes are discussed further in *Chapter 3—Tax Haven Compliance Risks.* As the process was in the early stages of rollout, the ANAO did not review in detail the case work of the OCP. The ANAO analysis showed that the OCP had established a framework for case selection and had documented roles, responsibilities and relevant processes.

**4.18** The ANAO notes that the case work of OCP concentrates on civil matters alone. Where matters move from 'civil' to 'criminal', cases are managed by a different business line—SNC. SNC is also the compliance business line responsible for Project Wickenby which includes a focus on offshore activities with a criminal element. As previously discussed there are formal and informal relationships between these two business lines that need to be maintained and possibly strengthened.

### *Promoters*

**4.19** The role of a promoter is central to many tax haven compliance cases, whether it's a specific product or a boutique arrangement. Promoters can operate both onshore and offshore to encourage Australian residents to engage in tax haven related transactions. A promoter usually seeks to: 'bend or abuse the law rather than break it'[33]. Within the Tax Office the direct responsibility for promoter intelligence and compliance rests with the ATP business line. As discussed in *Chapter 1—Background and Context,* the direct operations of ATP were not within the scope of this audit. During the course of the audit the ANAO did seek to understand the relationships between the relevant business lines and how the differing compliance activities informed other areas of the Tax Office of tax haven compliance risks.

**4.20** The ANAO analysis showed that there were sound frameworks for the transfer of case work and intelligence surrounding promoters with offshore

[33] Tax Office internal document.

elements. When OCP gathered sufficient intelligence in the case of a promoter it would be subsequently referred to ATP or SNC for further work. This would be subsequently tracked through the committee process of the THAG to ensure relevant outcomes were known and any emerging issues were flagged. The Tax Office also advised the ANAO that the newly implemented case management system—part of the Easier, Cheaper and More Personalised Change Program—also serves to strengthen the understanding between the different business lines of case activity and current issues.

## International activities

**4.21** The Tax Office is actively involved in international forums as part of their compliance activities. The international forums, in particular those within the OECD, have played a significant role in concentrating efforts and creating a dialogue around tax havens in a global context. The Tax Office aims to leverage from the international dialogue to develop its own strategies and course of action. In 1998 the OECD first released a criteria based list of 'tax havens'[34] and a course of action for OECD nations to counter the growing risk to revenue that tax havens posed. The course of action included removing OECD nations own preferential tax regimes and treaty negotiation with tax havens to facilitate exchange of information. The international strategy of the OECD is to

> '…achieve a global level playing field in the areas of transparency and effective exchange of information for tax purposes…. in a way that is fair, equitable and permits fair competition between all countries, large and small, OECD and non-OECD.'[35]

**4.22** While the OECD has set the direction of the strategy, individual member nations have the responsibility to enter into TIEAs to help create the level playing field. In 2002, the OECD developed a model agreement aimed at ensuring the implementation of high standards of transparency and effective exchange of information in both civil and criminal taxation matters.

### Tax Information Exchange Agreements (TIEAs)

**4.23** TIEAs for the Tax Office serve a dual purpose, they:

- act as a deterrent to taxpayers using tax havens to conceal income and assets; and

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[34] See further Appendix 1.

[35] OECD, *Tax Cooperation, Towards a Level Playing Field*, 2006.

- are a compliance tool to help address non-compliance.

**4.24** In 2002 the Tax Office embarked on an ambitious project to scope the possibility of negotiating TIEAs with all tax havens that made political commitments to improve transparency and to establish effective exchange of information in civil and criminal tax matters. The negotiation of any treaty is a resource intensive exercise, and given the level of response and particular risk that tax havens pose to Australia, the Tax Office tailored their program to concentrate on those jurisdictions most likely to result in successful negotiations.

**4.25** Australia has concluded agreements with three countries to date.[36] The Tax Office is actively negotiating agreements with seven other countries and the Isle of Man has agreed to sign an agreement with Australia. The ANAO notes the advanced progress the Tax Office has made in negotiating agreements in comparison to other OECD nations. Australia is second only to the United States of America in the number of agreements negotiated and has actively pursued agreements with every declared non-OECD participating partner tax haven.

**4.26** The role of the Tax Office in negotiating TIEAs is unique as Treasury has been responsible for the negotiation of new comprehensive tax treaties and protocols since 1 July 2002. The role of the Tax Office is usually limited only to interpreting existing treaties and protocols and to administering Australia's network of other international treaties. The ANAO notes this particular arrangement delivers specific synergies as the Tax Office is able to bring direct experiences of implementing a TIEA to the negotiation of a TIEA.

## Staff Capability

**4.27** The Tax Office has identified staff capability development as a key ongoing issue for tax haven related compliance work and for international transactions more generally. The consolidation and building of staff capability was one of the central elements to the revised Tax Office *Tax Haven Strategy*, 2006, which instigated the establishment of the OCP. In July 2007 the Tax Office developed a *Skilling Strategy: Offshore Compliance Program*. Under the strategy, deliverables for staff training have been provided, these included in-house seminars, specific university tailored courses, and intranet based skilling packages. The ANAO notes the strategy was developed within a short time frame after the establishment of the OCP and could be enhanced to include, for

[36] This includes: Bermuda, Antigua and Barbuda, and Netherlands Antilles.

example, measurable targets. The ANAO considers that staffing and staff capability are issues the Tax Office will need to continue to monitor closely during the life of the OCP. Developing and implementing a revised skilling strategy will be critical for the Tax Office to achieve its aim of tax haven risk identification as part of 'business as usual'.

## Measuring the performance of compliance activities

**4.28** Recording and analysing the outcomes of active compliance and non-audit compliance activities is important to inform future planning and targeting of compliance risks. Performance measurement provides one means of shifting the focus from the level of resources to the use of those resources. Performance measurement can:

- help clarify objectives and responsibilities;
- promote analysis of the relationships intra-agencies and between programs;
- make performance more transparent, allowing assessment of whether program objectives are being met; and
- encourage ongoing performance improvement.

### Performance assessment and evaluation

**4.29** Prior to the establishment of the OCP, the reporting of tax haven compliance activities was disparate and varied, in part due to the nature of the compliance risk that traverses numerous compliance issues. Historically, different business lines had tax haven compliance responsibility which was not always separately reported or distinguished from their other activities, making consolidated reporting difficult. With the consolidation of numerous tax haven compliance activities into the OCP, the Tax Office has significantly improved its capacity for accurate performance reporting. The performance reporting for OCP is conducted through the management structure as discussed in *Chapter 2—Management Arrangements*.

**4.30** The Tax Office indicated to the ANAO that OCP will be a distinct compliance group for at least 3 years, at which point its organisational location will be evaluated. Recording and analysing the outcomes of active compliance and non-audit compliance activities is important to inform future planning and targeting of compliance risks. The Tax Office has set a range of effectiveness measures surrounding the OCP's activities ranging from the:

'Reduced use of tax havens to avoid Australian taxation obligations' through to the 'Community perceives Tax Office is adequately addressing the abusive use of tax havens'. The method of measurement, however, did not necessarily inform the extent of success; there was often no direct link between the measurement and the key outcome. The Tax Office also did not consistently set benchmarks or estimates of what success looks like in their business case or program plan. The Tax Office has only made a high level assessment of their compliance assistance products as part of the whole Tax Office assessment.

**4.31** The ANAO notes the difficulty encountered by the Tax Office in measuring their success given the 'unknown factor' of tax haven compliance risks. Nevertheless, the ANAO considers there should be greater alignment between the Tax Office's performance effectiveness measures and the current compliance strategies. This would assist the Tax Office's ability to assess the effectiveness of their treatment strategies over time. The Tax Office advised that creating a robust framework for evaluation is an ongoing process that will be annually reviewed.

**4.32** The ongoing evaluation of the activities of the OCP is critical to inform future compliance activities. The ANAO notes that in June 2007 the Tax Office undertook an internal review regarding the effectiveness of the compliance measures surrounding tax haven compliance risks. The review made several recommendations regarding the 11 core effectiveness indicators. The recommendations are a positive step towards allowing better assessment of the impact of their activities. The ANAO considers that given a core outcome in relation to the tax haven risk relates to community perception, greater focus could also be placed on measuring the behavioural change of taxpayers through qualitative assessment.

## Recommendation No.3

**4.33** The ANAO recommends that, following the first annual cycle of the current performance effectiveness measures, the Tax Office tests, reviews and where appropriate amends the performance measures relating to their compliance strategies for tax haven compliance risks.

**4.34** **Tax Office Response:** *Agreed*. The Tax Office has made a significant investment over the last 12 months in developing a process to measure the effectiveness of our compliance activities. The Tax Haven project was used as a pilot to develop and test the methodology. As noted in the report at paragraph 4.32 the Tax Office is currently putting in place processes to measure the impact of the effectiveness indicators developed for the Tax Haven strategy. These measures will be continuously reviewed and improved as part of that project.

Ian McPhee
Auditor-General

Canberra ACT
29 May 2008

# Appendices

# Appendix 1: Agency Response

Australian Government
Australian Taxation Office

SECOND COMMISSIONER OF TAXATION

Mr Peter White
Group Executive Director
Performance Audit Services Group
PO Box 707
CANBERRA ACT 2608

Dear Mr White

**ANAO Performance Audit:**

**The Australian Taxation Office's Strategies to Address Tax Haven Compliance Risks**

Thank you for the opportunity to comment on the ANAO's proposed report on *The Australian Taxation Office's Strategies to Address Tax Haven Compliance Risks audit.*

**Summary of comments**

The Tax Office welcomes the Australian National Audit Office's (ANAO) recommendations in relation to its strategies to address tax haven compliance risks.

The concealment of assets and income in tax havens in an attempt to put them beyond our scrutiny is an ongoing challenge for the Tax Office. As the report acknowledges, the Tax Office is well regarded by the Organisation for Economic Cooperation and Development (OECD) and its member nations for its innovative strategies and activities in dealing with tax haven compliance risks.

The audit did not cover the full spectrum of our tax haven work including Project Wickenby and the joint work we are doing with other countries on emerging schemes. However, the report acknowledges that our response to tax haven work has included a range of risk treatment strategies including audit work, prosecutions, treaty negotiations, voluntary disclosure initiatives, leveraging off international experience and an increased focus on marketing and education.

It is encouraging to note that the ANAO found that the Tax Office has adopted a sound risk management framework for tax haven compliance risks and has in place appropriate strategies in relation to tax haven compliance risk identification and assessment. In addition, the report specifically acknowledges that the

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framework has been adjusted to provide enhanced governance and appropriate focus on the risk and whole of Tax Office co-ordination at both formal and informal levels.

As noted in the report the Tax Office is the only tax administration within the OECD to have a publicly available strategy document regarding tax haven compliance issues, in the form of its *Tax havens and tax administration* publication. The report further notes the advanced progress that the Tax Office has made in negotiating Tax Information Exchange Agreements in comparison to other OECD countries and acknowledges that the Tax Office has been able to bring the experiences of exchanging tax information under a tax treaty to the negotiation of a TIEA.

The Tax Office accepts the three recommendations and provides the following comments.

**Recommendation No. 1**
**Para 2.13**

*The ANAO recommends that, to improve its organisational leadership and strategic direction on tax haven matters, the Tax Office's Tax Haven Steering Committee performs its roles and responsibilities on an ongoing basis as set out in its charter.*

**Agreed**

**Comment:** The Tax Haven Steering Committee (THSC) has been operating on an informal basis with a focus on establishing the broad strategy and resources to manage the tax haven risk. The THSC members have also met as part of other Tax Office governance processes, for example Plenary Governance Forum and the Income Tax Steering Committee. We accept the need to formalise these arrangements. The Tax Office has now in place a three tiered interlocking governance structure to guide and support its tax haven strategy at the strategic and operational level. This includes the THSC, the Tax Haven Advisory Group and Tax Haven Community of Practice. These arrangements are in addition to the sound governance and risk management arrangements that operate at business line, corporate and cross agency level.

**Recommendation No.2**
**Para 3.39**

*The ANAO recommends that the Tax Office improve its assessment of the extent of the tax haven compliance risks through greater trend analysis of qualitative and quantitative data.*

**Agreed**

**Comment:** The Tax Office, along with other tax administrations, is continuing to improve the understanding of the risks posed by the inappropriate use of tax havens. The Tax Office uses data from AUSTRAC to monitor transfers to and from tax havens. As the report indicates, our

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analysis of this data has shown that the majority of transactions with tax havens are legitimate reflecting the position that these jurisdictions have in the global financial system. It has proved to be difficult to get robust estimates of the extent of the tax risk. The use of intermediate destinations to transit transactions further complicates this process. The Tax Office will continue to reconcile high level flows to tax havens with specific analysis of transactions considered high risk to improve its view of the relative risk of various tax havens. This will also include working in partnership with Austrac to further enhance our analytic capability.

**Recommendation No. 3**
**Para 4.33**

*The ANAO recommends that, following the first annual cycle of the current performance effectiveness measures, the Tax Office tests, reviews and where appropriate amends the performance measures relating to their compliance strategies for tax haven compliance risks.*

**Agreed**

**Comment:** The Tax Office has made a significant investment over the last 12 months in developing a process to measure the effectiveness of our compliance activities. The Tax Havens project was used as a pilot to develop and test the methodology. As noted in the report at paragraph 4.32 the Tax Office is currently putting in place processes to measure the impact of the effectiveness indicators developed for the Tax Havens strategy. These measures will be continuously reviewed and improved as part of that project.

If there are any questions concerning our response, please contact Mr Paul Duffus, Deputy Commissioner Large Business and International, on 02 62162376

Yours sincerely

J Granger

Jennie Granger
Second Commissioner of Taxation

20 May 2008

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# Appendix 2: Comparative list of OECD and Tax Office identified tax havens

| OECD list of tax havens* | Tax Office list of tax havens |
|---|---|
| Andorra[2] | Andorra[2] |
| Anguilla[3] | Anguilla[3] |
| Antigua and Barbuda | |
| Aruba[3] | Aruba[3] |
| Bahamas | Bahamas |
| Bahrain | Bahrain |
| Bermuda | |
| Belize | Belize |
| British Virgin Islands[3] | British Virgin Islands[3] |
| Cayman Islands | Cayman Islands |
| Cook Islands | Cook Islands |
| Cyprus | Cyprus |
| Dominica | Dominica |
| Gibraltar | Gibraltar |
| Grenada[3] | Grenada[3] |
| Guernsey[3] | Guernsey[3] |
| Isle of Man[3] | |
| Jersey[3] | Jersey[3] |
| Liberia | Liberia |
| Liechtenstein[2] | Liechtenstein[2] |
| Malta[4] | |
| Marshall Islands | Marshall Islands |
| Mauritius | Mauritius |
| Monaco[2] | Monaco[2] |
| Montserrat | Montserrat |
| Nauru[3] | Nauru[3] |
| Netherlands Antilles | |
| Niue | Niue |
| Panama | Panama |
| Samoa | Samoa |

| OECD list of tax havens* | Tax Office list of tax havens |
|---|---|
| San Marino | San Marino |
| Seychelles | Seychelles |
| St Kitts & Nevis | St Kitts & Nevis |
| St Lucia | St Lucia |
| St Vincent & Grenadines | St Vincent & Grenadines |
| Turks & Caicos Islands | Turks & Caicos Islands |
| US Virgin Islands[1] | |
| Vanuatu | Vanuatu |

Note [1] Australia is able to access Tax Information from the US Virgin Islands through US tax treaties and information exchange agreements, and the Tax Implementation Agreement between the United States of America and the Virgin Islands and as a consequence is not considered to be a Tax Office identified tax haven. See further ATO Practice Statement Law Administration PS LA 2006/4 available from <http://www.law.ato.gov.au>>.

Note [2] These tax havens have not yet committed to transparency and effective exchange of information.

Note [3] Australia is currently in the process of negotiating a TIEA.

Note [4] The Tax Office advised the ANAO that following recent changes to their legislation, Malta now meets the OECD's standard on transparency and effective exchange of information. This means that they should no longer be considered by Australia as a tax haven, as of the 22nd April 2008.

Source: *OECD, *Towards Global Co-operation, Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs,* Paris, 2000. See <<http://www.oecd.org/document/19/0,3343,en_2649_33745_1903251_1_1_1_1,00.html>> [accessed 1 December 2007].

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