

The Auditor-General
Audit Report No.34 2009–10
Performance Audit

The Management and Use of Double Taxation Agreement Information Collected through Automatic Exchange

Australian Taxation Office

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of Australia 2010

ISSN 1036-7632

ISBN 0 642 81125 3

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Canberra ACT
18 May 2010

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*.

Pursuant to *Senate Standing Order 166* relating to the presentation of documents when the Senate is not sitting, I present the report of this audit and the accompanying brochure. The report is titled *The Management and Use of Double Taxation Agreement Information Collected through Automatic Exchange*.

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's Homepage—<http://www.anao.gov.au>.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian McPhee'.

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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Contents

Glossary and Abbreviations	8
Summary and Recommendations	9
Summary	11
Introduction	11
Audit objective and scope	12
Conclusion	13
Key findings by chapter.....	15
Tax Office response	21
Recommendations	22
Audit Findings and Conclusions	23
1. Background	25
Introduction	25
International taxation.....	26
Double taxation agreements	28
Australia’s double taxation agreements	29
Exchange of information (EOI).....	31
Administration of automatic exchange of information (AEOI)	32
Recent developments	33
Previous audits.....	34
Audit overview	34
2. Strategic Directions for International Information Exchanges.....	36
Introduction	36
Motivation to exchange information	37
Impediments to the effective use of AEOI.....	39
AEOI international engagement.....	40
AEOI data described.....	43
Incoming AEOI data	44
Outgoing AEOI data	46
Compliance Plan - AEOI integration.	48
Risk awareness and engagement.....	50
3. AEOI Governance	57
Introduction	57
OECD contribution to DTA governance	57
Double tax agreement negotiation	59
Legislation	60
Automatic Exchange of Information Steering Committee.....	61
Exchange of Information Advisory Committee.....	63

4. Information Security and Privacy	64
Introduction	64
Information Security Practice Review	65
Australian Government information security requirements.....	66
AEOI security characteristics	66
Unencrypted data transfer	68
Encryption tool usage.....	68
Password usage.....	70
AEOI security practice.....	73
AEOI stand-alone computing environment	74
Privacy	76
5. AEOI usage in Compliance Activities.....	77
Introduction	77
Compliance activities using automatically exchanged information.....	77
General observations.....	78
Tax Practitioner and Lodgment Services (TPALS).....	79
Micro Enterprises and Individuals	81
Large Business and International (LB&I)	88
Small and Medium Enterprises (S&ME)	88
Summary of AEOI compliance activities	91
Compliance activity coordination	91
Identity matching	92
Appendices	97
Appendix 1: Tax Office Response	99
Appendix 2: OECD assessment reports.....	101
Series Titles.....	106
Current Better Practice Guides	109
Tables	
Table 1.1 Trends in taxpayers with foreign source income (FSI).....	27
Table 1.2 Australian Double Tax Agreement network.....	30
Table 3.1 Australia's oldest DTAs.	60
Table 4.1 Security characteristics compared for AEOI data received and sent by the Tax Office.....	67
Table 4.2 AEOI encryption programs compared	69
Table 4.3 Encryption program usage	70
Table 4.4 Actual and estimated WinZip password recovery times.....	71
Table 4.5 Observed WinZip frequency of password usage	72
Table 5.1 TPALS lodgement enforcement activity	79
Table 5.2 Micro Enterprises AEOI compliance exercise case selection	83

Table 5.3	Individuals foreign source income active compliance exercises case selection	85
Table 5.4	Individuals active compliance pre-lodgement advisory letter exercise	86
Table 5.5	Individuals AEOI active compliance exercise results	87
Table 5.6	Comparison of S&ME foreign source income active compliance exercises using AEOI data	89
Table 5.7	S&ME active compliance exercise outcomes.....	90
Table A2-1	OECD progress report on implementation of the internationally agreed tax standard (2 April 2009).....	102
Table A2-2	OECD progress report on implementation of the internationally agreed tax standard (20 January 2010).	104

Figures

Figure 1.1	Cumulative number of Australian DTAs	29
Figure 2.1	Timeline of Automatic Exchange of Information significant events	37
Figure 2.2	AEOI incoming data by dollar value.	45
Figure 2.3	AEOI incoming data by number of records received by the Tax Office.	45
Figure 2.4	AEOI outgoing data by dollar value.....	46
Figure 2.5	Value of AEOI components sent by the Tax Office.....	47
Figure 2.6	AEOI outgoing number of records sent by the Tax Office.....	48
Figure 2.7	Tax Office Compliance Model of behaviour	53
Figure 5.1	Identity matching of AEOI records over time.....	94
Figure 5.2	Identity matching confidence achieved by the Tax Office for received AEOI data, for financial period, 2003-2007.	95

Glossary and Abbreviations

AEOI	Automatic Exchange of Information. Bulk data exchange between tax administrations in accordance with a DTA.
DTA	Double Tax Agreement; a bilateral agreement between jurisdictions to avoid double taxation and to prevent fiscal evasion.
GFC	Global Financial Crisis. This term is used broadly in this report to refer to the decline in global economic activity during 2007–09 that significantly damaged the global financial sector and resulted in a decline in consumer wealth and significant worldwide government economic intervention.
OECD	Organisation for Economic Co-operation and Development.
SES	Senior Executive Service – the senior level of executive leadership within the Australian Public Service.
SMF	Standard Magnetic Format – a schema for the interchange of AEOI data.
STF	Standard Transmission Format – a schema for the interchange of AEOI data. Successor to the SMF.
TIES	OECD Working Parties No.8 and No.9 Sub-Group on Taxation Information Exchange System

Summary and Recommendations

Summary

Introduction

1. The Australian Taxation Office (Tax Office) is Australia's principal revenue collection agency. Under Australia's taxation law, individual taxpayers are subject to tax on their world-wide income. Globalisation of economic activity has meant that Australians now have considerable opportunities to undertake transactions internationally, especially via the Internet. Over one million Australians, increasing at approximately eight to 10 per cent year on year, derive foreign source income which may be subject to tax in Australia.

2. Double Tax Agreements (DTAs) are negotiated on behalf of the Australian Government by the Department of The Treasury, enacted under the *International Tax Agreements Act 1953* (Cth), and once operational are then administered by the Tax Office. Australia has entered into 42¹ DTAs with other jurisdictions. DTAs define which jurisdiction has the right to collect tax in particular circumstances and as such, assist in providing equity to taxpayers by preventing or limiting the double taxation of earnings. DTAs also enable the legitimate exchange of taxpayer information between jurisdictions, including through bulk periodic exchange, known as Automatic Exchange of Information (AEOI).

3. The Tax Office sends AEOI data to the relevant DTA jurisdiction where income is earned in Australia and there may be an obligation to pay tax in the partner jurisdiction. Reciprocally, DTA partners send AEOI data to Australia where an Australian resident has earned income overseas and Australia may have the right to collect tax from that individual.

4. AEOI contributes to the transparency of international taxpayer economic activity. From the perspective of the Tax Office, increased transparency provides an opportunity to better understand and oversee the activities of Australians. AEOI data may also contribute to compliance activities conducted by the Tax Office. This compliance oversight occurs in the

¹ The Assistant Treasurer, the Hon. Nick Sherry announced (March/April 2010) that new Tax Treaties (DTAs) had been signed with Chile and Turkey. At the time of preparing this report these DTAs are not yet in force and are not counted in the 42 DTAs.

context of Australia's self assessment system which requires taxpayers to declare all of their assessable income and claim only those deductions and offsets to which they are entitled.

5. The Tax Office has advised that its compliance programs to date have suggested that the overall risk to voluntary compliance in relation to income derived from overseas sources for some markets is high. Compliance activities can range from targeted correspondence campaigns designed to inform and educate taxpayers and encourage self-disclosure, to complex tax audits.

6. Taxpayer privacy is a significant operational issue for the Tax Office, especially when sending and receiving taxpayer information to external sources. In this regard, the Tax Office has obligations to exchange AEOI data in a manner which is consistent with the *Privacy Act 1988* (Cth), and the legislative authority provided through the *International Tax Agreements Act 1953* (Cth) covering DTAs.

Audit objective and scope

7. The objective of the audit was to review and assess the use, and management of, automatic exchanges of information under Double Taxation Agreements (DTAs) by the Tax Office.

8. The ANAO considered the strategic directions followed by the Tax Office in setting its business and operational policies in regard to AEOI, as well as the governance arrangements in place. As there is an inherent risk of unauthorised access to, or inappropriate disclosure of, taxpayer information when undertaking international transfers of large quantities of taxpayer data, the ANAO examined the security of AEOI transfers, and considered the obligations of the Tax Office under the *Privacy Act 1988* (Cth). The ANAO also considered the effectiveness of the use of AEOI data in the context of compliance activities conducted by the Tax Office.

9. The audit did not examine other additional and complimentary data transfer methods enabled by DTAs which facilitate the transfer of taxpayer information between DTA partners; these methods are outlined in paragraph 1.24.

Conclusion

10. The Tax Office is increasingly reliant on its data matching capabilities as an effective and efficient way to achieve high levels of voluntary compliance by taxpayers under Australia's self-assessment system. DTAs with other jurisdictions, as enacted through Australian legislation, provide a framework that assists the Tax Office's operational capability to assess risks and encourage compliance in relation to the taxation of the worldwide earnings of Australian taxpayers.

11. DTAs outline the rights and obligations of Australia and the relevant co-signatory under the agreement including protocols governing the exchange of taxpayer information between jurisdictions. DTAs provide the potential to assist the Tax Office to identify transactions relating to taxpayers with international economic interests and assess their Australian tax obligations in respect of those transactions. The Tax Office's ability to exchange taxpayer information internationally, and the subsequent use of AEOI data in compliance exercises, also act as a deterrent to non-compliance by taxpayers.

12. The Tax Office faces a number of challenges and limitations in establishing and managing the use of AEOI data as part of its compliance program activity. AEOI transfers occur across international boundaries, resulting in operational complexities, many of which are largely outside the control of the Tax Office. These include: differences in language, legal systems, time zones, financial year-ends and the organisational priority afforded to AEOI in different jurisdictions. These complexities result in impediments to the effective use of AEOI data for compliance activities, both in terms of the Tax Office's ability to match the AEOI record to Australian taxpayers, and being positioned to take full advantage of the data made available.

13. Notwithstanding the challenges and limitations involved in the international transfer of large amounts of taxpayer information, the ANAO concluded that the Tax Office's management of the AEOI program has generally been sound, and that the Tax Office has generally made appropriate use of the bulk taxpayer information that it has received under DTAs. Further, the Tax Office continues to encourage ongoing improvement in the quantity and quality of AEOI transfers with Australia's DTA partners.

14. Efforts to increase AEOI activity by the Tax Office and some DTA partners have occurred over a significant length of time. The Tax Office, for example, participated in trials of a paper-based exchange of taxpayer

information in the early 1980's, and exchanged data electronically in 2000. Over time, the Tax Office has increased the quantity and value of the AEOI records which it sends to overseas jurisdictions. The quantity of incoming data has also increased, and the Tax Office's ability to achieve an identity match, necessary for efficient database assisted compliance activity, has improved.

15. The effective use of AEOI data within the Tax Office relies upon the coordination of a range of technological, compliance and administrative capabilities which are distributed throughout the Tax Office. The Tax Office established governance structures which provided coordination and oversight, initially only of AEOI activities, and more recently of a range of exchange of information activities which occur under DTAs, in addition to AEOI.

16. The Tax Office's now superseded AEOI Advisory Committee provided a forum for discussion of AEOI use in compliance activities across the Tax Office. There is scope to further increase the compliance knowledge base by coordinating greater sharing of information relating to DTAs generally and the availability and potential use of AEOI data more specifically through the newly constituted EOI Advisory Committee. This could involve, for example, purposefully scheduling compliance exercises to build on the experience and knowledge already gained by business line areas in using AEOI data.

17. The inherent risk to the Tax Office in the AEOI program is significant, given the likely reaction of taxpayers to a privacy breach involving unauthorised access to, or inappropriate disclosure of, taxpayer information; regardless of whether the AEOI data was being sent or received by the Tax Office. AEOI data may be transferred securely through the use of encryption technologies, reducing the potential for unauthorised access to the data and decreasing the reputational risk to the Tax Office that would result from a breach of taxpayer privacy.

18. The Tax Office transfers the vast majority of data in an encrypted state, although this has not always been the case.² Where data is encrypted, one of the tools the Tax Office used is more susceptible to being used inappropriately, including through weaker password selection and encryption, hence the protection applied to AEOI data is at greater risk of being compromised. The Tax Office could reduce this risk for outgoing data by using alternative

² Evidence existed that unencrypted information had been sent in 2007; ANAO analysis did not extend significantly before this date.

technologies where supported by DTA partners. Similarly, the Tax Office may influence, but can not control, the security practices of DTA partners that send AEOI data to it. The ongoing monitoring and reinforcement of DTA partner AEOI security practices by the Tax Office would assist in reducing the risk of privacy breaches resulting from AEOI data loss or compromise.

19. Whilst no instance of a breach of privacy was identified during the audit, and the Tax Office was not aware of any instance, the risk of a privacy breach requires ongoing attention and management. The Tax Office has introduced procedures over the course of this audit to reduce the risks associated with sending AEOI data.

20. The ANAO has made two recommendations directed towards improving the Tax Office's effective use of AEOI data in its compliance activities.

Key findings by chapter

Strategic Directions for International Information Exchanges (Chapter 2)

21. The Tax Office has a long history of developing the operational capabilities and international linkages with DTA partners essential for establishing and expanding the AEOI program. Past government decisions, including the selection of which jurisdictions to enter into DTAs with, determine present day opportunities available to the Tax Office.

22. The volume and dollar value of incoming AEOI data available for use by the Tax Office has been increasing over time. Additionally, the ability to derive a high confidence identity match between the incoming AEOI data and existing Tax Office records has also exhibited a positive trend. These two factors combined mean that there is more AEOI data that is suitable for use in case selection and compliance activities.

23. The use of AEOI data by the Tax Office in compliance exercises has increased from a low base over the last five years. AEOI related work is conducted by a number of Tax Office business line areas, which provides the opportunity to leverage the specialist compliance knowledge that exists within the market segments for example, Individuals and Small to Medium Enterprises.

24. Given the market segment based organisational structure of the Tax Office, there is no specialist AEOI compliance area that focuses solely on leveraging AEOI for compliance purposes. Consequently, advances in AEOI data usage methodologies require deliberate and purposeful sharing of information within the Tax Office. With the increased use of AEOI data by the Tax Office, compliance methodologies have been able to be improved, informed by the experience of previous exercises. The Tax Office could improve the mechanisms for sharing information between the areas which contribute to the effective use of AEOI data, including technical, administrative coordination and compliance areas, by more efficiently capturing information and increasing its accessibility.

25. The Tax Office sends a large number of reports on AEOI data quality to overseas jurisdictions. These standardised reports are an important tool to provide an AEOI users perspective on errors, omissions and means of improvement. The Tax Office receives few standardised feedback reports from overseas DTA partners.

AEOI Governance (Chapter 3)

26. The Organisation for Economic Development (OECD) provides an important international focal point for DTA operational discussion. The OECD has authored a Model Convention³ to assist in the negotiation of new DTAs. The involvement of the OECD assists in the creation of an international framework and an increased degree of standardisation on which international cooperation on tax matters is based. The OECD has also released an information exchange manual⁴ and standardised quality feedback report specifications⁵ to assist DTA partners improve their level of service to each other over time.

27. Within Australia, the AEOI program is governed by the DTAs which are enacted through Schedule amendments to the *International Tax Agreements Act 1953* (Cth). Administratively, DTAs are negotiated by the Department of the Treasury (Treasury), on behalf of the Government. The Tax Office provides advice to Treasury on matters of tax administration to inform these

³ OECD Model Tax Convention on Income and on Capital.

⁴ <<http://www.oecd.org/dataoecd/61/19/40502506.pdf>> [accessed 29 April 2010].

⁵ <<http://www.oecd.org/dataoecd/61/14/40502226.pdf>> [accessed 29 April 2010].

negotiations and is responsible for administering the DTAs after they are enacted.

28. Within the Tax Office, the effective use of AEOI relies upon the coordination of a range of distributed technological, administrative coordination and compliance capabilities. Compliance areas using AEOI data are informed by their experiences, gained through their general activities engaging with different market segments of taxpayers.

29. The AEOI function is supported through a cross-organisational committee. Historically, the Automatic Exchange of Information Steering Committee has focussed exclusively on AEOI. Much of the committee's efforts were directed at increasing the amount of AEOI exchanged and AEOI data use throughout the Tax Office.

30. In 2009, the Tax Office reconfigured the governance structure and created the Exchange of Information Advisory Committee, providing oversight of all forms of international information exchange occurring under DTAs, including AEOI. The updated Charter for this committee was formally approved during April 2010.

Information Security and Privacy (Chapter 4)

31. The potential reputational risk to the Tax Office inherent in the transfer of data is significant in the event that personal taxpayer information is lost, or accessed by unauthorised parties. This risk is particularly relevant to the AEOI program where large volumes of data are exchanged across international boundaries on a regular basis.

32. AEOI necessarily involves the sending and receipt of taxpayer information between international tax jurisdictions. The Tax Office has an obligation to secure the taxpayer data that it sends. Given that the AEOI data sent to the Tax Office by overseas DTA partners is expected to relate to Australian residents, the Tax Office also has a vested interest in influencing incoming international transfer practices, such that Australian taxpayer data is sent to it securely by DTA partners.

33. There have been occurrences overseas involving bulk data loss by government agencies which has been widely reported in the press⁶ and resulted in public inquiry⁷. Whilst such instances did not occur within the context of an AEOI program, the public reaction to the security breach provides useful insights into how a breach of AEOI program security may be regarded in the Australian community.

34. AEOI data is sent/received using a number of methods. AEOI data may be transmitted electronically via e-mail⁸, or, transported physically via CD-ROM using postal, courier or diplomatic services. Irrespective of how the data is transported, the Advanced Encryption Standard (AES) encryption algorithm may be used to effectively secure AEOI data prior to transmission.

35. When sending AEOI data to DTA partners, the Tax Office primarily utilises two encryption programs to secure it; WinZip and Pretty Good Privacy (PGP⁹). The Tax Office sends the largest volume of data, to a small number of DTA partners, using PGP. Conversely, the Tax Office sends only a small proportion of data by volume, to a large number of DTA partners, using WinZip.

36. Both PGP and WinZip utilise the AES, but WinZip also offers user-selected encryption methods which are less secure. WinZip relies on a user-entered password to protect encrypted information, whereas in contrast, PGP relies on a computer generated key. As a result of inadequate training and

⁶ See <<http://news.bbc.co.uk/2/hi/7104945.stm>> and <<http://news.bbc.co.uk/2/hi/7103566.stm>> [accessed 29 April 2010].

⁷ Independent Police Complaints Commission (2008), "IPCC independent investigation report into loss of data relating to Child Benefit", United Kingdom. In its 25 June 2008 press release, the IPCC made the following comments "The IPCC's investigation uncovered failures in institutional practices and procedures concerning the handling of data. It revealed the absence of a coherent strategy for mass data handling and, generally speaking, practices and procedures were less than effective. The IPCC found that there was: a complete lack of any meaningful systems; a lack of understanding of the importance of data handling; and a 'muddle through' ethos. Staff found themselves working on a day-to-day basis without adequate support, training or guidance about how to handle sensitive personal data appropriately." The full report is available at: <http://www.ipcc.gov.uk/final_hmrc_report_25062008.pdf> [accessed 29 April 2010].

⁸ The Australian Government Information and Communications Technology Security Manual (available at <<http://www.dsd.gov.au>>) states that the Internet is treated as Unclassified network infrastructure. AEOI data is categorised In-Confidence by the Tax Office. Even though AEOI information is categorised by the Tax Office at a higher security level than the security level provided by the Internet it is still possible to transmit it over the internet providing the AEOI data is adequately protected through an appropriate encryption algorithm, such as AES.

⁹ When PGP was piloted by the OECD, Australia was a participant in this initiative.

usage WinZip is more susceptible to poor security outcomes where users make poor password¹⁰ and encryption algorithm choices.

37. The ANAO examined a large number of AEOI records transmitted by the Tax Office to review WinZip password usage. AEOI data had been sent using the same passwords to multiple DTA partners, on multiple occasions. This created a risk of an unauthorised recipient being able to inappropriately access data intended for another DTA partner. In addition, short and non-complex passwords had been used providing weakened protections, even when AES is used. However, there was no record on Tax Office registry files that this vulnerability had been exploited.

38. AEOI data has been both sent and received in unencrypted form via the postal service or hand delivery with officers of DTA partners. The risks inherent in AEOI transfer would be minimised if AEOI data was always encrypted when being transported.

39. The password procedures used by the AEOI coordination area were informed by guidance which is more appropriate to a computer logon context; the guidance provided less than optimal protections in the context of AEOI.¹¹ Over the course of this audit, the Tax Office has adopted improved procedures to provide greater assurance that strong encryption is applied and longer, more complex passwords are used. The Tax Office also installed an updated version of WinZip to take advantage of updated application configuration options that further reinforce complex password use guidance.

40. Within the Tax Office, AEOI encryption occurs on a stand-alone computer which is not linked to the main Tax Office network. This computer is able to send/receive encrypted information to external e-mail accounts. At the start of this audit users had administrative access privileges. The Tax Office has since improved computer security by limiting users to non-administrative access privileges.

¹⁰ A poor password would be one which is short, non-complex and/or contains elements which are easily guessed.

¹¹ A computer logon environment generally requires a shorter, less complex password, particularly as it is expected that passwords must be able to be remembered by users. Additional protections are also available in a network environment, which are not available in the AEOI context, such as only allowing a specified number of logon attempts before the user account is frozen. In contrast, should encrypted AEOI data archive fall into the wrong hands, an infinite number of compromise attempts may be made until success is achieved.

41. The Tax Office commissioned a general review of information security practices, which pre-dates this ANAO audit, and as a result, the Tax Office implemented an Information Security Risk Manager (ISRM) role. Its purpose is to provide additional assurance of the security procedures that are adopted where information, including AEOI data, is sent from the Tax Office to external recipients. Additionally, the Tax Office instituted an Information Transfer Gatekeeper process. The Gatekeeper process is designed to mitigate against the loss of high risk data sets.

AEOI Usage in Compliance Activities (Chapter 5)

42. Over the past five years, the Tax Office has increased its use of AEOI data. Efficient use of AEOI data in compliance exercises is supported by an identity matching capability which provides a means to match AEOI data to the Tax Office's Tax File Number client register, at an assigned level of confidence. Compliance exercises examined over the course of this audit required a high level of identity matching confidence as a pre-cursor to further case selection refinement. Over time, the proportion of AEOI data which can be matched at a high level of confidence has increased. However, because of DTA partner specific differences, the data matching confidence level which the Tax Office is able to achieve varies significantly between DTA partners.

43. Compliance exercises using AEOI data have been undertaken in four areas of the Tax Office, covering both individuals and corporate entities. Some areas have conducted multiple exercises and have been able to use that experience to improve the effectiveness of AEOI data use.

44. Compliance exercises undertaken to date involving AEOI data have typically achieved low measurable outcomes. Exercises based on correspondence campaigns utilising AEOI data for case selection have been the most efficient.

45. Following completion of ANAO audit fieldwork the Tax Office advised that AEOI data would be manually examined with the intent of referring potentially high risk cases to compliance areas for further action.

46. Given that AEOI compliance exercises are undertaken by a number of different areas within the Tax Office, there are opportunities to increase effectiveness and efficiency by using the AEOI Advisory Committee to consider the methodological basis for compliance activities which intend to use AEOI data, and to facilitate its use with other complementary databases.

47. Sharing information more effectively between compliance areas and between technical areas (for example, risk assessment and identity matching) would better position potential compliance activities. This would result from compliance staff gaining a better understanding of the availability, opportunities and limitations of using AEOI data. Building on existing intranet based solutions may provide a cost effective means to capture and promulgate existing and new knowledge.

Tax Office response

48. The ATO welcomes the Australian National Audit Office's (ANAO) recommendations in relation to its management and use of Double Taxation Agreement information collected through automatic exchange.

49. Automatic Exchange of Information (AEOI) contributes to the transparency of taxpayer's international economic activity. Increased transparency provides an opportunity to ensure that taxpayers are appropriately declaring income derived overseas. AEOI contributes to compliance activities conducted by the Tax Office. In particular I note your finding that:

Over the past five years, the Tax Office has increased its use of AEOI data. Efficient use of AEOI data in compliance exercises is supported by an identity matching capability which provides a means to match AEOI data to the Tax Office's Tax File Number client register, at an assigned level of confidence.

50. This should provide reassurance to the community that it can have confidence in this important aspect of our tax administration.

51. As noted in the report, the Tax Office has a long history of developing the operational capabilities and international linkages with Double Tax Agreement (DTA) partners essential for establishing and expanding the AEOI program. In addition the report acknowledges notwithstanding the challenges and limitations involved in the international transfer of large amounts of taxpayer information, the Tax Office's management of the AEOI program has generally been sound. Further, the Tax Office continues to work with Australia's treaty partners to encourage ongoing improvement in the quantity and quality of AEOI transfers.

52. The Tax Office's response is included in full at Appendix 1.

Recommendations

Recommendation No.1

Para 2.24

The ANAO recommends that, to facilitate effective compliance strategy development, the Tax Office consolidate its DTA information exchange knowledge into a centralised information repository.

Tax Office Response: *Agreed.*

The ATO is in the process of establishing a central information area on our intra net to capture and share intelligence at a strategic level on our work relating to AEOI cases. This information will be made available to ATO staff to support the use of automatic EOI data for compliance purposes. This will include sharing methodologies and outcomes to facilitate more effective approaches to use of the automatic EOI data. The EOI Advisory Committee will oversight the implementation of this initiative.

Recommendation No.2

Para 5.50

The ANAO recommends that, in developing compliance strategies to address identified compliance risks, the Tax Office have regard, when appropriate, to the learnings gained from previous compliance activities utilising AEOI data.

Tax Office Response: *Agreed.*

The ATO, along with other tax administrations, is continuing to improve its use of AEOI data. We are developing strategies to use AEOI data more effectively, in conjunction with other data sources to identify and address compliance risks. When established, the central information area will assist in analysing and sharing the learnings gained from previous compliance activities.

Audit Findings and Conclusions

1. Background

This chapter provides a description of Double Tax Agreements (DTAs) and an overview of the compliance context of DTAs within the Tax Office. It also provides information on the conduct of the audit.

Introduction

1.1 The Australian Tax Office (Tax Office) is the principal revenue collection agency for the Australian Government. In 2008–09 net cash collections from taxpayers by the Tax Office were \$264.5 billion and the operating expenditure of the Tax Office was \$3.025 billion. At 30 June 2009 the Tax Office employed 22 429 employees.¹²

1.2 As a general rule Australian resident taxpayers are subject to tax on their world-wide income. Over one million Australians, increasing at approximately eight to 10 per cent year on year, derive foreign source income, which may be subject to tax in Australia.

1.3 Australia is a signatory to 42 Double Tax Agreements (DTAs) with other jurisdictions that define which jurisdiction has the right to collect tax in particular circumstances. DTAs prevent or limit the double taxation of earnings by taxpayers. DTAs also enable the legitimate exchange of taxpayer information; including through bulk periodic exchange, known as Automatic Exchange of Information (AEOI).

1.4 The Commissioner of Taxation is given powers and functions under several Acts of Parliament; this audit is particularly concerned with functions relating to the *International Tax Agreements Act 1953* (Cth) (the Act), that gives legislative effect to the DTAs to which Australia is a signatory.

1.5 The various Australian tax treaties, as enacted into Australian law by the Act, permit bilateral exchange of information with DTA partners. These exchanges of information can take many forms, including AEOI. The Tax Office typically performs AEOI with DTA partners on an annual basis.

¹² Australian Taxation Office, *Annual Report 2008–09*, p. iv.

International taxation

1.6 Economic activity is increasingly globally interconnected. Advances in technology have enabled the conduct of financial transactions wherever internet connectivity is available and facilitates the international trade of a broad range of goods and services.

1.7 The Tax Office, similar to tax administrations in other countries, is under increasing pressure to protect the domestic revenue base in light of the challenges created by this trend towards globalisation.

1.8 The Global Financial Crisis (GFC) has resulted in a reduction in Australian tax revenues. At the time of the handing down of the 2009–10 Budget the Government anticipated that tax receipts would reduce by \$210 billion over the four years to 2012–13.¹³ This figure was later revised in the 2009–10 Mid-Year Economic and Fiscal Review, with estimated taxation receipts expected to be \$170 billion lower.¹⁴

1.9 In August 2009 the Tax Office noted that:

“Our experience has also been that difficult financial times result in some people taking more risks. This requires us to be extremely vigilant in detecting possible abuse of Australia’s tax and superannuation systems. The temptation to engage in risky activity increases as people and businesses struggle to stay in operation. In hard times the disreputable prey on the vulnerability of others, to engage in fraudulent activity.”¹⁵

1.10 The OECD commented in November 2009 on the impacts of the crisis on revenue collection and budgets as follows:

“The recession is taking its toll on tax receipts across the OECD. Aggregate tax burdens in OECD economies, calculated as the ratio of tax revenues to gross domestic product, or GDP, were unchanged between 2006 and 2007, and then fell in 2008. The reduction in the tax burden in 2008 is estimated to have been some ½ per cent of GDP, from 35.8 per cent to an estimated 35.2 per cent. Many more OECD countries saw falls rather than increases in their tax burdens in 2008. Tax burdens are also likely to have fallen further in 2009. Tax receipts often fall proportionately more than GDP in a recession and on top of

¹³ Australian Government Budget Overview 2009–10.

¹⁴ 2009–10 Mid Year Economic and Fiscal Outlook.

¹⁵ Mr Bruce Quigley, Second Commissioner of Taxation (compliance), to the Tax Institute of Australia, 13 August 2009.

that many OECD countries cut taxes in late 2008 and early 2009 to support aggregate demand following the financial crisis of September 2008.”¹⁶

1.11 The globalisation of economic activity and the impacts of the GFC have heralded greater urgency to facilitate international cooperation in tax administration matters.

1.12 The OECD published reports which assessed the extent to which countries had implemented measures to enhance transparency and cooperation. The OECD’s April 2009 assessment generated considerable discussion on publication. Issues referred to extensively in the international media include suggestions that less compliant countries were facilitating tax haven activity, promoting unfair international tax competition by eroding the revenue base of the taxpayer residence state, and facilitating illegal activity due to a lack of transparency arising from secretive banking activity. Since that time, the OECD has updated the report and the January 2010 report shows considerable improvement in international tax transparency over a short period of time. Both reports are reproduced at Appendix 2.

1.13 As part of the growing level of global economic activity, there has been an increasing trend for Australian taxpayers to receive foreign source income, as shown in Table 1.1.

Table 1.1

Trends in taxpayers with foreign source income (FSI)

	Income year					
	2003	2004	2005	2006	2007	2008
Taxpayers declaring FSI (000's)	864	886	943	991	1035	1039
Average FSI \$	2104	2190	2255	2415	2755	2858
Gross FSI (\$000's)	1817	1940	2126	2393	2853	2969

Source: Tax Office.

¹⁶ OECD Tax New Alert – 24/11/2009 (opt-in listserv e-mail).

1.14 The Tax Office recognised in its 2008–09 compliance program the benefit of making use of many complementary information sources¹⁷, including international transactions, to provide effective monitoring and compliance/assurance coverage of taxpayer activity:

“We are making more systematic use of data matching to verify tax compliance of international transactions. Data on an increasing range of financial transactions is automatically exchanged with over 40 foreign tax administrations. Even where information is not readily available, as is the case with tax havens, we systematically analyse Australian Transaction Reports and Analysis Centre (AUSTRAC) data on international financial flows to identify the overseas assets and income of Australian residents”¹⁸

Double taxation agreements

1.15 Earning income in more than one tax jurisdiction can lead to ‘double taxation’: the levying of tax by two jurisdictions against the same income. Examples of income which could suffer from double taxation include, but are not limited to, overseas pensions, interest, royalties and income from personal services. To minimise the impact of double taxation, governments negotiate treaties (agreements) with provisions that clarify the rights of jurisdictions to impose tax in particular circumstances.

1.16 In recognition of increasing levels of international economic activity, and the consequent increasing likelihood of double taxation occurring, many jurisdictions use a model DTA sourced from the OECD as the starting point for negotiations between tax administrations.¹⁹ Membership of the OECD is not a requirement to enter into a DTA with Australia, or to use the OECD model convention.²⁰ The model convention facilitates operational efficiencies through international familiarity across tax administrations.

1.17 There are benefits in entering into a DTA based on the model convention as the framework under which information is exchanged is internationally familiar. While DTAs facilitate many types of information

¹⁷ Sources identified by the Tax Office include AUSTRAC, DIAC, ASIC, Austrade, the Australian Stock Exchange, Share registries and Customs.

¹⁸ Tax Office 2008–09 Compliance Program, available at <www.ato.gov.au>.

¹⁹ The history of the Model Tax Convention dates back to 1958 when the Organisation for European Economic Cooperation introduced the document. Later this entity would become the OECD.

²⁰ OECD Model Tax Convention on Income and on Capital.

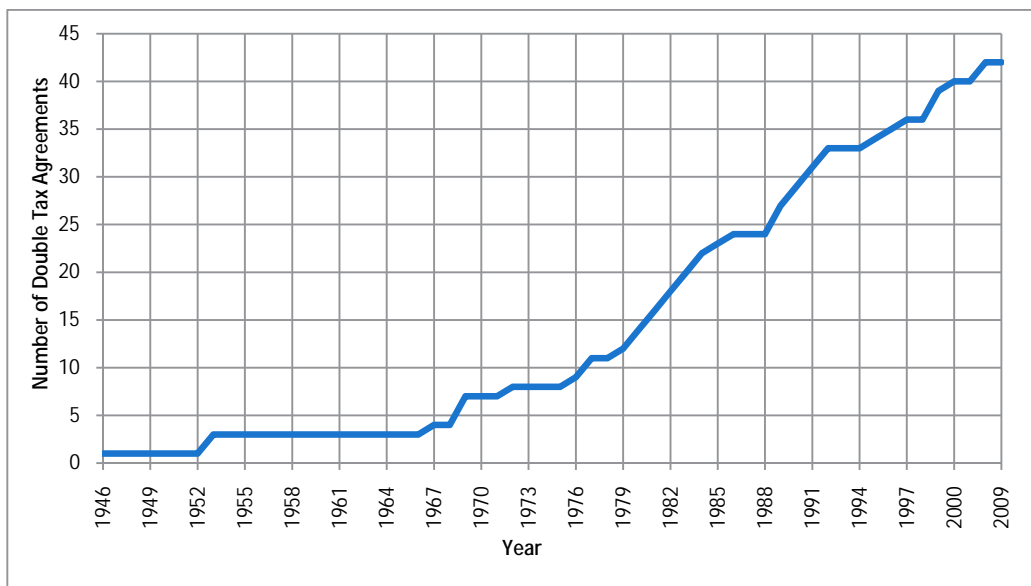
exchange (as outlined in paragraph 1.24, below), this audit focuses on the voluntary exchange of bulk data covered by clauses within each of Australia's DTAs referred to as Automatic Exchange of Information.

Australia's double taxation agreements

1.18 The first DTA Australia signed was with the United Kingdom in 1946; followed by the United States of America (1953), Canada (1957) and New Zealand (1960). More recently, the Australian Government has on average entered into one new treaty every year²¹, see Figure 1.1, below.

Figure 1.1

Cumulative number of Australian DTAs



Source: ANAO analysis of Treasury DTA information, available at <www.treasury.gov.au>.

1.19 Table 1.2, below, outlines the Australian DTA network, which includes Australia's top 10 trading partners, as reflected in the rankings shown. Trade rankings can vary significantly between years and are effected by factors including commodity prices, exchange rates, economic growth and seasonal influences.

²¹ Tax Information Exchange Agreements are not included as explained in paragraph 1.33; this form of agreement does not enable AEIOI, but does enable specific information exchange. DTAs enable both AEIOI and Specific exchange.

1.20 DTAs may be entered into for a range of public policy reasons including promoting regional ties and providing a means to increase the transparency of transactions which may serve to deter tax avoidance behaviour.

1.21 The Department of the Treasury (Treasury), on behalf of the Government, conducts negotiations with potential treaty partners. The Treasury utilises the assistance of other agencies during this process, including the Tax Office. Once a DTA has been enacted in both Australia and the partner jurisdiction, the Tax Office is responsible for its administration.

Table 1.2

Australian Double Tax Agreement network.

Australian DTA network as of June 2009		
Argentina, 43	Italy, 14	Singapore, 6
Austria, 35	Japan, 2	Slovak Republic, 69
Belgium, 25	Kiribati, 116	South Africa, 22
Canada,	Malaysia, 12	Spain, 29
China, 1	Malta, 103	Sri Lanka, 56
Czech Republic, 55	Mexico, 30	Sweden, 26
Denmark, 36	Netherlands, 18	Switzerland, 24
Fiji, 47	New Zealand, 9	Taipei (Taiwan)
Finland, 32	Norway, 45	Thailand, 8
France, 15	Papua New Guinea, 19	United Kingdom, 5
Germany, 10	Philippines, 31	United States, 3
Hungary, 49	Poland, 51	Vietnam, 16
India, 7	Republic of Korea, 4	
Indonesia, 13	Romania, 66	
Ireland, 27	Russia, 33	

Source: <www.ato.gov.au>, accessed on 5 June 2009, <www.dfat.gov.au> accessed February 2010.

Note: The Assistant Treasurer, the Hon. Nick Sherry announced (March/April 2010) that new Tax Treaties (DTAs) had been signed with Chile and Turkey. At the time of preparing this report these DTAs are not yet in force and are not counted in the 42 DTAs.

1.22 DTAs are worded to enable a degree of administrative flexibility; sovereign governments change tax administrative practices regularly and DTAs must remain workable without the need for frequent re-negotiations. However, re-negotiations do occur, particularly where new concepts in taxation arrangements are introduced. For example, over the years specific clauses covering capital gains tax and indirect taxes have been included in Australian tax treaties.

Exchange of information (EOI)

Types of taxpayer information exchange

1.23 The exchange of (taxpayer) information (EOI) between jurisdictions may be authorised through entering into a DTA. EOI provides additional transparency to cross-border taxpayer financial activities and assists to disrupt illegitimate tax avoidance.

1.24 Information is exchanged for a variety of reasons; ranging from routine monitoring of financial transfers to gathering evidence on the activities of a specific individual or entity. DTAs provide for a range of different types of information exchange:

- **Specific:** One jurisdiction requests highly targeted taxpayer information from another jurisdiction;
- **Spontaneous:** One jurisdiction passes on information gained in the normal course of administering its own domestic tax laws that it considers will be of assistance to another jurisdiction, without the other jurisdiction making an initiating request;
- **Industry-wide:** exchange of industry sector information between jurisdictions; typically involves authorised representatives from a number of DTA partners meeting to discuss the selected topic. Discussions could cover sectoral operations and linkages, finance schemes, tax evasion threats, trends and appropriate practical and policy level responses;
- **Simultaneous:** an arrangement by two or more DTA partners to examine the affairs of a particular taxpayer in their own jurisdictions but on the same time scale and in respect of the same issues, with a view to exchanging relevant information obtained; and

- **Automatic (AEOI):** the systematic, and ideally regular, transmission of bulk information relating to taxpaying entities understood to be resident in the jurisdiction receiving the AEOI. The information exchanged can include categories of income including: dividends, interest, royalties, salaries and pensions.²²

Administration of automatic exchange of information (AEOI)

1.25 The Tax Office's administration of the AEOI process is coordinated by the International Relations Section within the Large Business and International area within the Tax Office. AEOI with DTA partners is undertaken under the authority of a position with powers designated as a "Competent Authority".

1.26 The Competent Authority role is recognised in DTAs, and is reflected in the *International Tax Agreements Act 1953* (Cth). Designation as an Australian Competent Authority denotes a person who is authorised to provide taxpayer information sourced in Australia and to make requests of other DTA partners for taxpayer information sourced in that jurisdiction.

1.27 Staff within the Tax Office are specifically delegated to perform the Competent Authority function by the Commissioner of Taxation. Competent Authority delegates then authorise subordinate officers to sign documentation on their behalf.

1.28 A Competent Authority must authorise the release of AEOI information. There are approximately thirty positions which are delegated, or authorised to sign on behalf of delegates, in order to perform Competent Authority functions.

1.29 Incoming AEOI data is received in various forms, including paper documents and electronically. AEOI data which is provided in structured electronic formats is significantly more useful to the Tax Office and is able to be imported into the Tax Office's database systems, where it can be identity matched, manipulated and queried for case selection and compliance exercise use. Given the greater practical value of electronic records, the ANAO has focussed on reviewing the use of this resource in this audit.

²² The term "Automatic Exchange" should not be taken to imply a real-time interactive data feed. The Tax Office typically sends batches of AEOI data overseas on an annual basis.

1.30 The OECD has established electronic standards for AEOI exchange. The standard has changed over time, reflecting advances in technology. The basic interchange format is called Standard Magnetic Format (SMF) and contains the core set of exchange data. The OECD upgraded to a Standard Transmission Format (STF) that at present exists alongside the SMF. STF is a structured interchange format²³ that explicitly defines data elements and their characteristics, serving to increase data exchange integrity. More recent exchange standards provide a flexible foundation to better accommodate future developments in taxation and an expanded range of exchanged information elements.

1.31 The Tax Office also receives information in electronic spreadsheet format. However, the amount of data received using this format is minor. The OECD has not mandated a structure for data provided in this way, and senders of information determine the structure and the content of the data provided. As a consequence, whilst the data is identity matched, it is not loaded into the ATO data warehouse.²⁴

1.32 Third parties provide data to the Tax Office in response to a number of requirements, including Australian Annual Investment Reports (AIIR), Non-Resident Interest Dividend and Royalties (NRIDAR) Annual Reports and foreign resident withholding payments. The Tax Office uses this information to provide data sub-sets to DTA partners. These information sources are outlined in greater detail later in this report.

Recent developments

1.33 Although outside the scope of this audit, Tax Information Exchange Agreements (TIEAs) are a more limited form of international agreement increasingly being entered into by tax administrations.

1.34 TIEAs do not make provision for AEOI but provide a basis for Specific information exchange which is valuable in circumstances where a tax administration is conducting a tax audit or investigation.

²³ The interchange format is Extensible Mark-up Language (XML).

²⁴ The Tax Office advises that less than 0.08 per cent of records received in 2008/09 were in spreadsheet format.

1.35 As of 29 April 2010, Australia has entered into 23 TIEAs, of these, five are in force: Antigua and Barbuda, Bermuda, the Isle of Man, Jersey and the Netherlands Antilles.²⁵

Previous audits

1.36 Recent audits which the ANAO has conducted on related issues within the Tax Office include:

- ANAO Audit Report No.36 2007–08, The Australian Taxation Office's Strategies to Address Tax Haven Compliance Risks; and
- ANAO Audit Report No.30 2007–08, The Australian Taxation Office's Use of Data Matching and Analytics in Tax Administration.

Audit overview

Audit objective and scope

1.37 The objective of the audit was to review and assess the use, and management of, automatic exchanges of information transferred under Double Taxation Agreements (DTAs) by the Tax Office.

1.38 The ANAO considered the strategic directions followed by the Tax Office in setting its business and operational policies in regard to AEOI, as well as the governance arrangements in place. As there is an inherent risk of unauthorised access to, or inappropriate disclosure of, taxpayer data when undertaking international transfers of large quantities of taxpayer information, the ANAO examined the security of AEOI transfers, and considered the obligations of the Tax Office under the *Privacy Act 1988* (Cth). The ANAO also considered the effectiveness of the use of AEOI data in the context of compliance activities conducted by the Tax Office.

1.39 The audit did not examine other additional and complimentary data transfer methods enabled by DTAs which facilitate the transfer of taxpayer information between DTA partners; these methods are outlined in paragraph 1.24.

²⁵ <http://www.treasury.gov.au/documents/625/XLS/20100413_Australian_Tax_Treaty_Table.xls> [accessed 29 April 2010].

Audit methodology

1.40 The ANAO interviewed staff from various relevant areas of the Tax Office and Department of the Treasury as well as external stakeholders. Management processes, relevant files, meeting minutes and compliance methodologies, evaluations and outcomes were also reviewed.

1.41 The audit was conducted in accordance with ANAO auditing standards at a cost to the ANAO of \$455 500.

2. Strategic Directions for International Information Exchanges

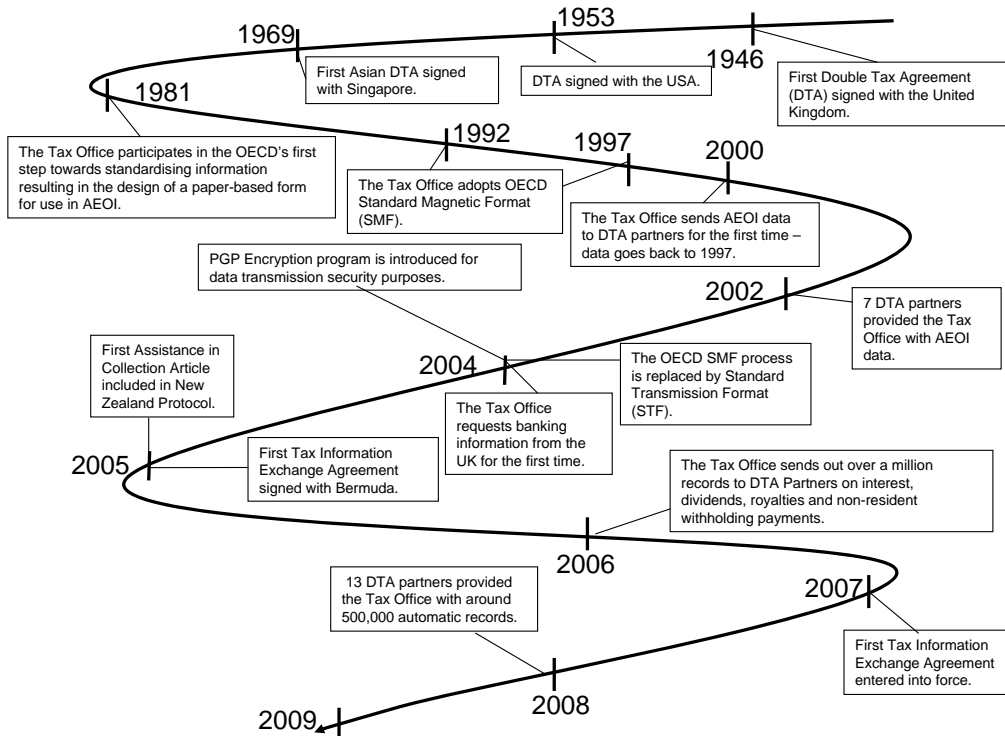
This chapter provides the context of the AEOI program, its development, description of AEOI data sent and received by the Tax Office, the Tax Office's Compliance Program, and the barriers to optimising the utilisation of AEOI data.

Introduction

2.1 The Tax Office recognised that a precursor to the operation of a successful automatic exchange of information program is having functional bilateral relationships with DTA partners. The Tax Office has an interest in assisting and extending the capability of DTA partners so that they have both the desire and capability to add value to taxation administration in Australia. The Tax Office also has an interest in assisting overseas tax jurisdictions in order to reinforce the integrity of the global revenue collection system.

2.2 Given that AEOI exchanges are optional, the Tax Office can only exert limited influence on a DTA partner to provide AEOI data. DTA partners have their own legal conditions, resource constraints, priorities, are at differing stages of administrative and general development, possess computing infrastructure of varying capability and often consider the utility of AEOI differently within their own individual domestic contexts. As a result, progress in expanding the quality and quantity of AEOI data received by the Tax Office has been slow and incremental, although improving.

2.3 Present day AEOI capabilities rest on significant historical efforts. Figure 2.1 outlines key development stages in the evolution of DTAs and AEOI.

Figure 2.1**Timeline of Automatic Exchange of Information significant events**

Note: The 2007 “First Tax Information Exchange Agreement” and 2005 “First Assistance in Collection Article” are not related to AEOL, and are included for broader context only.

Source: ANAO analysis of Tax Office information.

Motivation to exchange information

2.4 The scope of this audit is restricted to the Australian Tax Office. However, meaningful information exchange is bilateral, involving Australia’s DTA international partners. Incoming AEOL data, received from overseas DTA partners, is expected to relate to Australian residents who have earned income overseas. AEOL data which the Tax Office sends to DTA partners is expected to relate to taxpayers of foreign jurisdictions earning income in Australia. For example, the Tax Office may send AEOL data to Japan regarding Japanese citizens working in Australia.

2.5 A DTA creates an opportunity to exchange AEOL data, not an obligation to do so. Encouraging AEOL relies on being seen to be a good “corporate citizen”; being responsive and assisting others to improve.

2.6 The Tax Office has a generally non-discriminatory approach to sending AEOI data to DTA partners. Even if the Tax Office is not in receipt of AEOI data from a DTA partner, the Tax Office provides AEOI data where that DTA partner indicates it can make use of it.

2.7 The Australian experience in receiving AEOI data is mixed but steadily improving. DTA partners may not provide AEOI data for a range of reasons, but may still contribute to the bilateral relationship through cooperating in other forms of EOI; the Tax Office advised that it considers this broader perspective to be more important than a DTA partner's capacity to assist in a specific element of DTA activities.

2.8 The exchange of AEOI data has benefits as well as risks for the Tax Office, including those outlined below:

(a) benefits:

- an improved understanding of trends in taxpayer activity in the international environment;
- an additional information resource for monitoring and compliance activity to determine whether Australian taxpayers are meeting their obligations under Australian taxation law;
- positively influence taxpayer behaviour through the creation of a deterrent capability; and
- increase transparency of taxpayer behaviours.

(b) risks:

- reputational risk to the Tax Office should data loss occur, particularly of poorly protected data;
- reduced taxpayer confidence in the tax administration system, potentially leading to a decrease in compliance, should data loss result in a breach of privacy through unauthorised access;
- inefficient compliance activity within Australia on the basis of low quality AEOI data; and
- privacy breaches if AEOI sent to another tax administration is used for purposes unrelated to tax administration.

Impediments to the effective use of AEOI

2.9 A number of Australia's DTA partners face challenges in providing AEOI data in a form which is readily useable by the Tax Office, particularly within a computer processing context. While a number of the challenges are likely to be surmountable, some are structural and are unlikely to be overcome in the short term. The Tax Office has a limited ability to assist DTA partners overcome these impediments. Outlined below are factors which provide context to the AEOI management environment in which the Tax Office operates.

2.10 Language: The use of different languages by DTA partners forms a barrier that is technological and anthropological. Technologically, different languages may use different character sets; translation may prove problematic as non-standard alphanumeric characters are converted between different systems optimised for different languages and using different character sets. Unintentional inaccuracies may also be introduced as non-English names are anglicised, potentially inconsistently across different tax jurisdictions.

2.11 Legal systems: Some DTA partners have laws that limit the level of information exchangeable under DTA arrangements, including bank secrecy laws. In the international context, legal systems and traditions vary widely.

2.12 Technology: The 42 DTA partners are at differing stages of implementing AEOI programs. An effective technology based AEOI program is underpinned by a range of technological organisational capabilities including identity matching, infrastructure and human capability.

2.13 Priority: Strategic capabilities and operational requirements of the various tax administrations have an impact on their capacity to contribute to the Australian AEOI program. Specific information exchange may be considered more favourably than AEOI due to its highly targeted nature. Under a DTA, partners have considerable flexibility to decide how best to contribute to the bilateral relationship.

2.14 Different financial year end: The Australian financial year is not aligned with that observed by any DTA partners.²⁶ As a result, the compliance value of some data obtained through AEOI is diminished. At best, when

²⁶ Source: CIA World Factbook at <www.cia.gov>.

domestic data is incongruent with AEOI data, further action will require further investment in terms of compliance activity and cost.

2.15 Time lag: There can be a lag of two to three years before the Tax Office receives AEOI data from DTA partners for a particular period.

2.16 Identity matching: Identity matching involves using computer programming, typically within a database context, to match an external record against the Australian Tax Office's Tax File Number (TFN) client register, and appending a TFN to the external record with an assessed level of confidence. In most instances the Tax Office relies upon a high quality match to undertake compliance work; for a range of reasons discussed later, this is not always possible to achieve.²⁷

2.17 Quality of collected data: The quality of collected data may be degraded where it is inappropriately reported to an overseas tax administration, and where taxpayer information is collected on a different basis, for example where different rules are applied to similar circumstances across jurisdictions. Further, quality of data may be degraded where taxpayers have reported incorrectly.

2.18 Currency exchange rates: Exchange rate variations over a period of time create inaccuracies when a single aggregated figure is provided through AEOI. This problem is exacerbated during periods of high exchange rate volatility.

AEOI international engagement

2.19 Approximately 40 per cent of DTA partners have regularly sent AEOI to the Tax Office over the last five years.

2.20 The Tax Office regularly interacts with overseas tax administrations to facilitate AEOI, reflecting a cooperative approach by the Tax Office to resolve operational issues. This included negotiating data exchange and/or seeking to clarify the context of exchanges, for example the local legal situation, in order to increase the business value of the AEOI data received.

2.21 The Tax Office also interacts with DTA partners to explore methods by which data quality can be improved. In some occasions these interactions

²⁷ AEOI data which is not able to be computer matched at a high level of confidence may still be manually matched.

focused on the data itself; essentially highlighting the omissions and variances observed. Other interactions also sought additional data elements or refinements to the data provided to position the Tax Office to extract greater value from the existing AEOI resource; for example seeking the date of financial transactions in order to reduce the effect of non-aligned financial years.

2.22 The AEOI coordination area²⁸ of the Tax Office has developed a sound understanding of the challenges associated with AEOI operations. This knowledge is stored in various databases, spreadsheets and hardcopy files which were organised on a chronological basis.

2.23 Because AEOI work is conducted in many different areas of the Tax Office, there is potential benefit in centrally capturing relevant knowledge distributed throughout the organisation to increase its accessibility. An intranet solution, potentially building on the Tax Office's existing "e-wiki" intranet product, could provide increased visibility of information. Such a repository would enable the knowledge created by subject specialists across the Tax Office to be aggregated, shared and accessed more effectively. Subject matter which could be captured includes:

- (a) incoming AEOI data availability, coverage and identity matching quality information;
- (b) information on individual DTA partners (legal issues, relationship issues, experiences to date when making particular AEOI related requests to guide compliance staff);
- (c) technical information to guide AEOI data users on inherent opportunities and limitations to better inform case selection and compliance methodology design;
- (d) historical compliance exercise methodologies to provide a knowledge base for compliance practitioners formulating future exercises. A planned approach would provide an improved basis to capture improvements in compliance exercise design over time to better address identified risk; and

²⁸ The International Relations Section is the central point through which AEOI data is exchanged.

- (e) strategic input from the Exchange of Information Advisory Committee and users of AEOI data to provide a focus for the insights which are generated across the Tax Office informed by the experiences of compliance exercises which utilised AEOI data.

Recommendation No.1

2.24 The ANAO recommends that, to facilitate effective compliance strategy development, the Tax Office consolidate its DTA information exchange knowledge into a centralised information repository.

2.25 Tax Office Response: *Agreed. The ATO is in the process of establishing a central information area on our intra net to capture and share intelligence at a strategic level on our work relating to AEOI cases. This information will be made available to ATO staff to support the use of automatic EOI data for compliance purposes. This will include sharing methodologies and outcomes to facilitate more effective approaches to use of the automatic EOI data. The EOI Advisory Committee will oversight the implementation of this initiative.*

2.26 As indicated earlier, the quantity of AEOI data which the Tax Office receives from Australia's DTA partners is variable. In late 2008 the Tax Office initiated a survey with DTA partners that had not previously provided AEOI data. The survey was an initiative by the Tax Office conducted in order to further understand the issues which are impediments to greater AEOI program participation.

2.27 The survey sought feedback on whether the AEOI data sent by the Tax Office to foreign tax administrations was useful to them, whether there was the ability to reciprocate, and if not, what were the barriers to doing so. Additionally, respondents were requested to comment on the preferred technology to encrypt AEOI data.

2.28 The survey responses received were largely consistent, with the majority of DTA partners pointing to information technology barriers which prevented them from sending AEOI data. To a lesser extent legal barriers were cited, though in some instances respondents were hopeful these would be able to be rectified through legislative change some time in the future.

2.29 Most DTA partners requested that AEOI data continue to be received from Australia, even if they could not reciprocate. The majority of DTA

partners responding to the survey requested that AEOI data be provided in spreadsheet format, encrypted using WinZip.²⁹

2.30 Overall, the responses reaffirm that successful AEOI is dependent on taxation administrations possessing a range of capabilities, principally technology based, as well as appropriate legal authority. Even with goodwill, without these capabilities, effective participation in an AEOI program is unlikely.

AEOI data described

2.31 AEOI files consist of individual records containing two significant elements, identifying and quantitative data. The identifying fields contain information including name, address and date of birth. The quantitative fields contain information which relates to a particular financial event.

2.32 An AEOI record can pertain to a large number of events, including:

- change in taxable place of residence;
- ownership of and income from immovable property;
- dividends;
- interest;
- royalties;
- capital gains;
- salaries, wages and other similar remuneration in respect of employment;
- directors' fees;
- income derived by artists and sportspersons, pensions, salaries, wages including commissions and proceeds from gambling;
- remuneration for government services; and
- indirect taxes such as VAT/sales tax and excise duties.³⁰

²⁹ The survey which the Tax Office distributed specified one default encryption response, namely WinZip. The survey was therefore methodologically disposed to this being the default security encryption method response. Should an administration wish to use another security method, like PGP, responses required manual annotation on the survey response form. The implications of encryption technology usage are discussed later in Chapter 4.

³⁰ Substantially sourced from the OECD "*Manual On The Implementation Of Exchange Of Information Provisions For Tax Purposes*", Module 3, 2006.

Incoming AEOI data

2.33 The Tax Office is unable to control the amount and quality of AEOI data which is sent to it by DTA partners. However, the Tax Office may have a positive influence through education and outreach initiatives, particularly where capability issues are an impediment for tax administrations. For example, during the course of this audit, the Tax Office conducted a workshop for a number of DTA partners and exchanged practical advice and experience. Over time, such efforts can serve to increase the volume and quality of data and result in improving critical working relationships.

2.34 Whilst education outreach may deliver long term benefits, in the shorter term the Tax Office has limited ability to directly influence the quality of the data received from DTA partners. Efforts are made to improve the data once it is received, including by manipulating and formatting received data. In some circumstances involving poor quality data, the DTA partner is contacted as part of a follow up process.

2.35 Data provided by third parties, such as financial institutions, and on-forwarded by the DTA partner with limited or no integrity verification, may leave the Tax Office vulnerable to introducing unreliable data into its data warehouse. For example, the Tax Office has received data from a DTA partner where the data was provided to the authorities of that jurisdiction by a financial institution and other third parties with a decimal point error.³¹ The error in the data was only detected by the Tax Office through compliance activity. These type of problems highlight how risks, and eventually recipient costs attach to the AEOI data set.

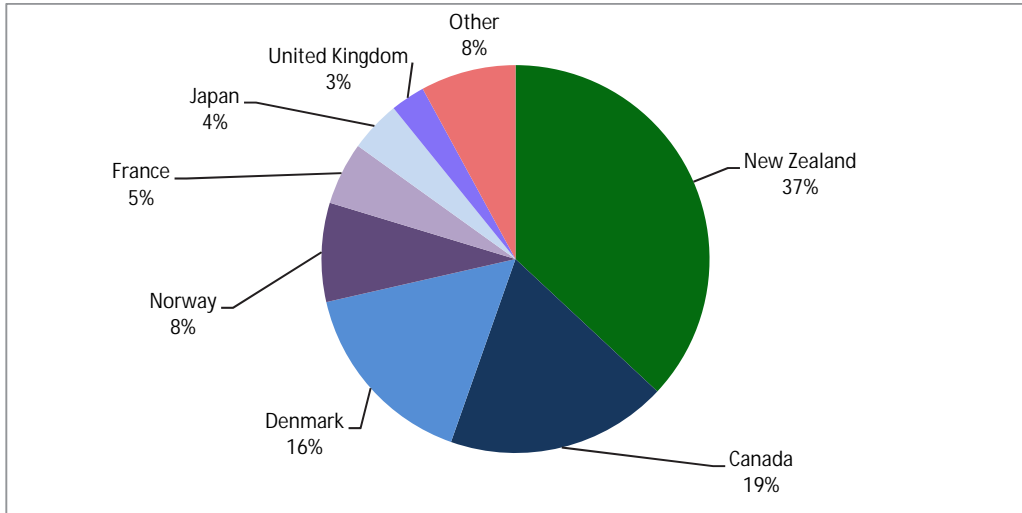
2.36 Incoming data provided to the Tax Office by DTA partners undergoes a process of identity matching and is loaded into a data warehouse, where it can be queried through database tools or other applications.

2.37 The total incoming records over the period 2003–2007 was valued at approximately \$15 billion, see Figure 2.2, below. This figure excludes amounts for the jurisdiction which had the decimal-point related issues outlined above.

³¹ For example, \$100.00 is reported as \$10 000.

Figure 2.2

AEOI incoming data by dollar value.

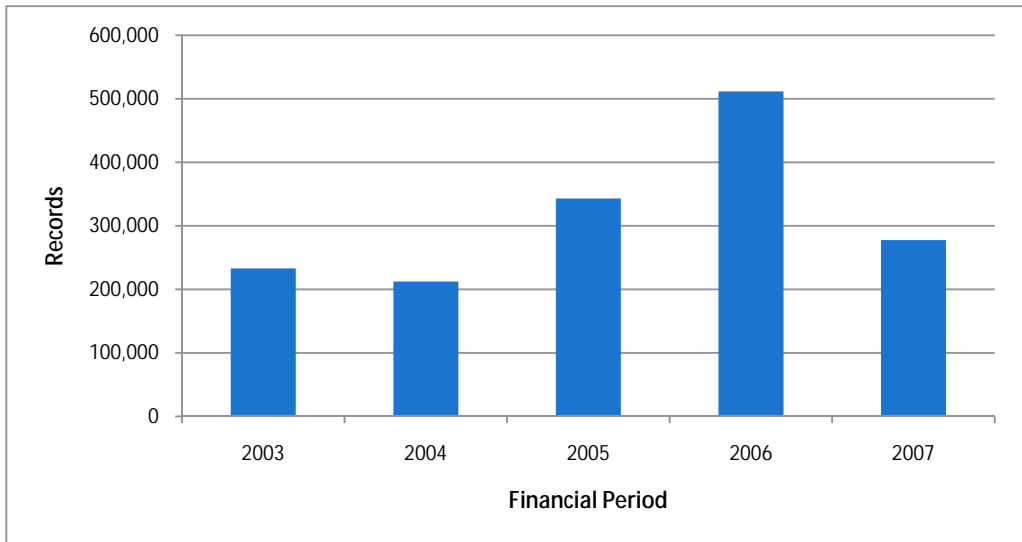


Source: ANAO analysis of Tax Office data.

2.38 The quantity of information made available to the Tax Office from DTA partners is gradually growing, see Figure 2.3, below.

Figure 2.3

AEOI incoming data by number of records received by the Tax Office.



Source: ANAO analysis of Tax Office data.

Note: The data is represented for the financial period to which the data relates. For example, some of the data relating to 2004 (and reflected in year 2004 above), may have been received in 2007.

2.39 The quantity of data recorded for 2007 reflects the historical time lag in receiving AEOI data. It is expected that additional data will be received over coming years.

Outgoing AEOI data

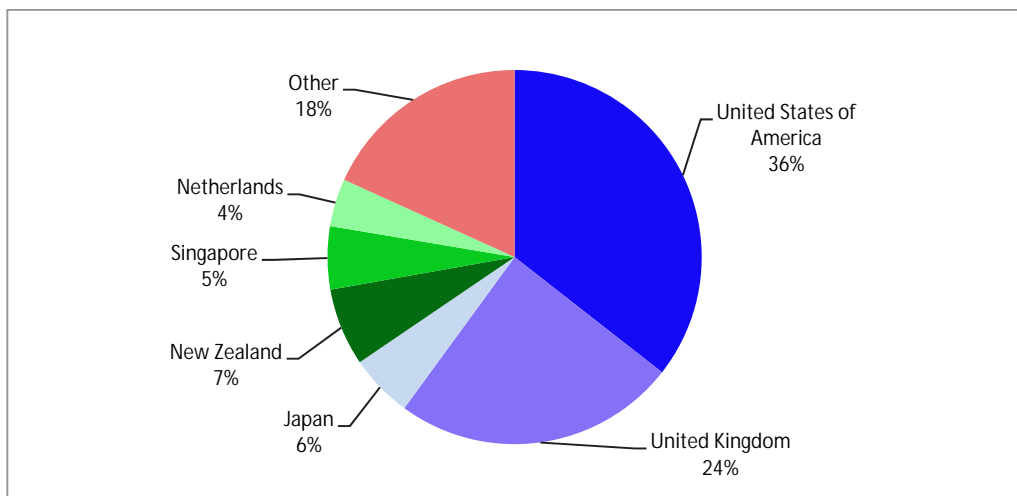
2.40 The AEOI data which Australia currently sends to DTA partners is collected from three sources. Annual Investment Income Report (AIIR) data is collected from Australian investment bodies such as banks, financial institutions and share registries. In 2005, the Tax Office supplemented AIIR information with data from the non-resident interest dividend royalties annual report (NRIDRAR). Also in 2005, the Tax Office included Foreign Resident Withholding (FRW) information. FRW forms part of the PAYG arrangements and requires payers of specific types of payments to foreign residents to withhold Australian tax at a set rate.

2.41 The data which the Tax Office provides to DTA partners is provided to it by third parties. There is a risk that those third parties may provide the Tax Office with data containing undetected quality problems.

2.42 By value, the majority of AEOI data provided by Australia is to the United States, the United Kingdom, Japan and New Zealand. Over the period 2005 to 2007 the Tax Office provided records with a value of \$47 billion, see Figure 2.4.

Figure 2.4

AEOI outgoing data by dollar value.

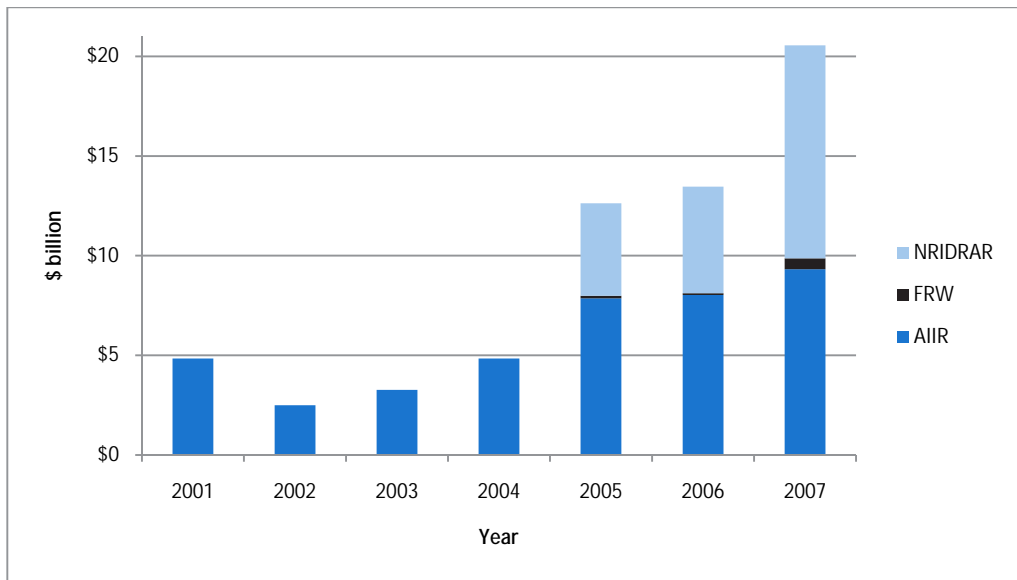


Source: ANAO analysis of Tax Office data.

2.43 The component elements of the AEOI data which the Tax Office sends has expanded with the introduction of FRW and NRIDRAR. They have had a minimal impact on the number of AEOI records sent, but have had a significant impact on their monetary value; see Figure 2.5.

Figure 2.5

Value of AEOI components sent by the Tax Office.



Source: ANAO analysis of Tax Office data.

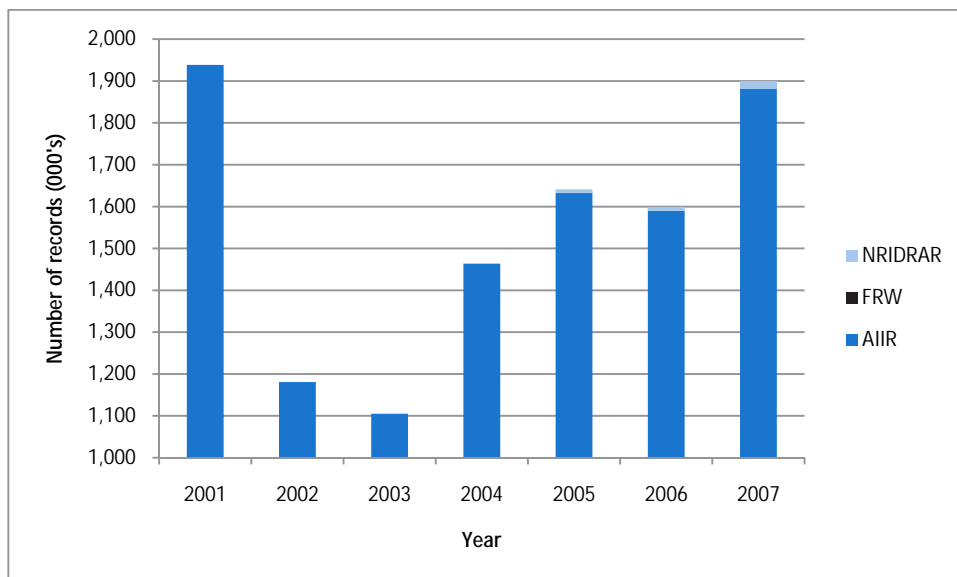
2.44 Despite the strong growth in outgoing AEOI value evident in Figure 2.5, the 2006 NRIDRAR data is lower than it otherwise might have been. The Tax Office advised:

“NRIDRAR data related to [the] 2007 year was extracted...in September 2008 and NRIDRAR data related to 2006 was extracted in May 2007. An additional 6,341 records with a value of \$3.5 billion...in relation to 2006 year were not extracted and sent to DTA partners. The reason is that these records were processed and completed after May 2007.”

2.45 The number of records provided to DTA partners is depicted in Figure 2.6.

Figure 2.6

AEOI outgoing number of records sent by the Tax Office



Note: While plotted, FRW data is not visible given the small quantity of records.

Source: ANAO analysis of Tax Office data.

2.46 In summary, the amount of both incoming and outgoing AEOI data reflects an increased commitment to the AEOI function over time by DTA partners. The data sent by the Tax Office, whilst exhibiting a degree of inter-year variation, reflects an ongoing increasing commitment to the provision of AEOI data to DTA partners.

Compliance Plan - AEOI integration.

2.47 The operating environment of the Tax Office is increasingly complex, particularly given the increase in international cash flows and economic activity. The Tax Office has acknowledged the importance of international economic activity through its compliance plans. The Tax Office compliance plans from 2002 to 2008 include that the Tax Office was:

- working with Treasury to ensure Australia's (DTA) treaty program is appropriate to government policy and business needs (2002–03);
- working with other tax administrations to improve exchange of information and to better align approaches to global compliance (2002–03);

- providing rulings, advice and assistance to taxpayers; continued the international public rulings program and developed a web presence for international issues (2002–03);
- undertaking research and risk identification and analysis, including record and data matching, to identify and quantify patterns and trends in populations and markets (2002–03);
- identifying non-residents involved in the GST system (2004–05); and
- scrutinising promoters of schemes that operate out of Vanuatu and the Pacific region, particularly where they have associates in Australia (2006–07).

2.48 The compliance plans between 2002 and 2006 convey a level of consistency in the presentation of the strategic directions of the Tax Office. In compliance plans for 2007–08 and later, international issues ceased being highlighted in a specific section; such activities were integrated throughout the Compliance Plan aligned to particular market segments. The 2008–09 Compliance Plan includes the following:

In the individuals market: “Under double tax agreements, we supply information to other countries about the Australian income of overseas residents who pay tax in Australia, including their investment income. We also receive information from participating countries on the income earned by Australian residents in those countries”³²

In the Small to Medium Enterprises market: “...target data matching, including the use of information provided by our overseas counterparts, to identify whether:

- businesses are complying with withholding obligations in respect of foreign residents and for overseas payments of interest, dividends and royalties;
- foreign residents with GST registrations are meeting their income tax obligations;
- foreign residents are declaring income or capital gains from taxable Australian property;

³² Australian Tax Office, *2008–09 Compliance Plan*, p. 14.

- Australian residents are declaring capital gains from overseas assets; and
- Australian residents are reporting their foreign income.”³³

Risk awareness and engagement

2.49 The effective use of AEOI data requires a good understanding by the Tax Office of the risks that exist in the taxpayer community. These are reflected in the compliance plans³⁴ published by the Tax Office. For example, in 2004–05 the Tax Office considered that the failure to disclose offshore income and/or foreign employment as worthy of compliance attention.³⁵

2.50 Compliance exercises conducted by the Tax Office using AEOI data contribute to addressing these risks. AEOI assisted the Tax Office to identify taxpayers reporting inappropriately, but further audit investigation is typically required to confirm the information which a taxpayer provides through self-assessment advice. In some instances, the Tax Office was able to efficiently resolve identified anomalies via correspondence with the taxpayer.

2.51 When selecting cases for further review based on AEOI data, the Tax Office must consider any known data quality issues with the AEOI data in order to select appropriate cases and use compliance resources effectively. For example, owing to non-aligned financial years across DTA partners compared with the Australian financial year, the Tax Office selected cases where observed variances between AEOI data and submitted taxpayer information were significant, creating a reasonable expectation that, even allowing for AEOI quality issues, reasonable outcomes were anticipated. In this context, the impediments to effectively utilising AEOI data serve to both increase the observed variances required before a case is selected and decrease the outcomes attained.³⁶

2.52 As a result of generally low practitioner familiarity with AEOI data, and quality issues when it was used, a significant proportion of Tax Office

³³ Australian Tax Office, *2008–09 Compliance Plan*, p. 39.

³⁴ See <www.ato.gov.au>.

³⁵ Australian Tax Office, *2004–05 Compliance Plan*.

³⁶ Some cash flows reflected in AEOI data are less subject to this problem; for example, information on pension payments are likely to be reasonably consistent, particularly where international rates of currency exchange are reasonably stable.

areas using AEOI data for compliance activities adopted methodologies which had the dual purpose of addressing identified taxpayer risks as well as exploring ways to maximise the benefits of AEOI data use. At the time of this audit, and given the compliance results detailed in Chapter 5, AEOI data has yet to clearly demonstrate that it can be used to consistently and predictably select high risk cases for compliance action to efficiently and effectively reduce non-compliance risk.

2.53 Despite the efforts of the Tax Office, AEOI data quality is an impediment to achieving satisfactory outcomes from compliance exercises. In the compliance exercise context, there are two elements of AEOI quality which determine the utility of AEOI data as a resource:

- (a) The identity matching confidence level that the Tax Office is able to achieve; and
- (b) AEOI data properties which determine whether the data is fit for purpose and can be used as anticipated to deliver the planned benefits in compliance exercises. These issues are not neatly defined and are influenced by the compliance methodology adopted and the specific AEOI data elements selected. However, issues such as AEOI data age, reliability, financial period, coverage and availability are relevant.

2.54 The Tax Office was aware of AEOI data quality issues and this appropriately influenced which AEOI data was used. For example, some compliance exercises selected AEOI data inputs from those DTA partners considered to be providing data of “higher quality”. One of the challenges faced by compliance managers is that it is difficult to determine the quality of an AEOI record (in terms of information content, not identity matching) until resources are expended to determine its veracity through a full compliance exercise.

2.55 AEOI data “quality” was not formally defined though a rigorous, repeatable or consistent assessment process. Without such a process, quality is inferred through opinion derived from the conduct of infrequent compliance exercises and may not be a reliable indicator. For this reason, should the Tax Office develop a methodologically sound basis to categorise AEOI data quality in a transparent and repeatable manner it would provide additional confidence to management that the benefits of a potentially improving AEOI data resource are recognised and, in due course, captured through compliance exercises. The insights gained should also be made available through a

knowledge sharing initiative to assist the users of AEOI data appreciate the opportunities available in the AEOI data resource.

Domestic operations - education campaign

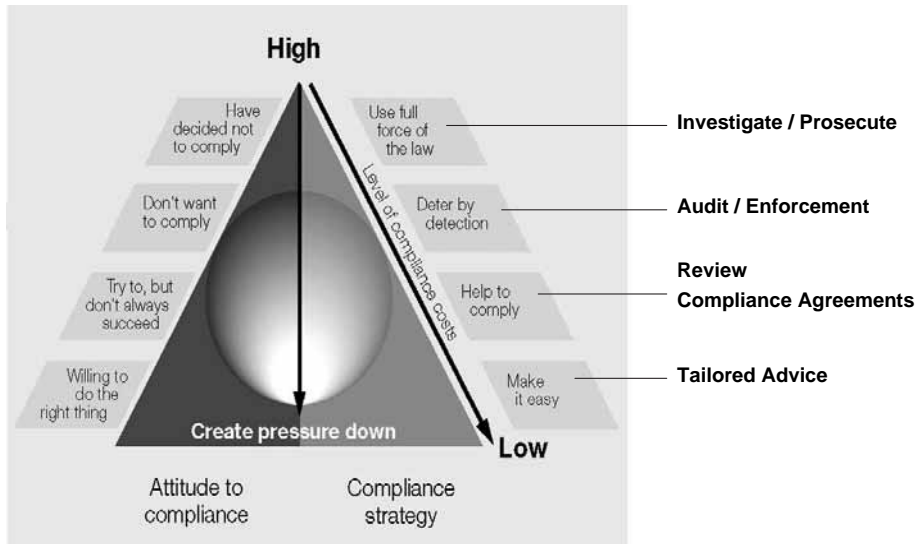
2.56 In the 2004–05 Compliance Program, the Tax Office identified that:

“we are concerned that some of these businesses and their advisers may not be fully aware of all their international tax declaration and lodgement requirements in relation to cross-border dealings.”³⁷

2.57 In a self-assessment system the Tax Office utilises a Compliance Model, see Figure 2.7, to better understand the factors that influence compliance behaviour and to guide the application of risk mitigation strategies. These strategies range from the communication of information to help taxpayers fulfil their obligations to criminal prosecution to stop and deter egregious non-compliance.

2.58 Taxpayer education has an important role in underpinning and improving compliance. The Compliance Model is predicated on experience indicating that most taxpayers try to meet their obligations. In that context, education initiatives are a cost-effective means of addressing compliance difficulties, particularly where messages can be well targeted to specific audiences.

³⁷ Australian Tax Office, *2004–05 Compliance Plan*, p. 50.

Figure 2.7**Tax Office Compliance Model of behaviour**

Source: Tax Office.

2.59 Over 75 per cent of taxpayers engage tax agents to complete their annual tax returns. The Tax Office is in the early stages of planning interventions specifically directed at increasing the awareness of tax agents to the obligations of Australian residents who derive income from overseas sources. Some materials had already been distributed, and further efforts are planned through a strategic communication campaign, which was at an early developmental stage during ANAO audit field work.

2.60 The ANAO notes that 2008–09 tax return forms used by individual tax payers do not require the taxpayer to declare the jurisdiction where foreign source income is derived. Information on non-individual foreign source income derived by company taxpayers is collected by requiring completion of Schedule 25A.

2.61 The Tax Office's Taxation Ruling IT 2514 provides background to the intent of Schedule 25A:

"The Overseas Transactions Information Schedule - 25A was introduced for companies on the 1986 return. Its introduction was a response to the ATO's increasing awareness of the taxation implications of international transactions. Whilst the information required by the schedule is not used in the assessment process, it is used to monitor the incidence and dollar value of transactions with related overseas entities. This can assist in determining audit priorities.

The provision of accurate detail may obviate the need for audits or may assist in deciding whether an audit can be limited to particular matters only.”

2.62 Schedule 25A provides the Tax Office with a basic level of visibility of international foreign transactions, collecting an indication of the primary country through which international dealings are conducted³⁸, as well as “amounts of attributable income” and “foreign non-assessable non-exempt income” by country. Detailed income information, by country, is able to be collected through subsequent compliance activity, if warranted.

2.63 Knowing the source of foreign source income would assist compliance staff when matching AEIO data with income information declared by the taxpayer.

AEIO data technical quality feedback reports

2.64 The exchange of AEIO data quality feedback reports between DTA partners is important. Structured and considered feedback from data recipients provides the originator of the AEIO data with valuable insights into how their data can be improved. Analysis of feedback from DTA partners exchanging AEIO data, provides the Tax Office with important insights into errors in data collection and data management. To assist in the exchange of efficient and consistent quality feedback the OECD suggests a feedback format, known as a “TIES SMF Auto Data Analysis and Feedback Report”, or, “TIES Report”.

2.65 The TIES report provides information on a number of specific issues reflecting data quality, including:

- identity matching statistics: including matched/unmatched statistics and confidence levels;
- comments against data fields: incorrectly formatted or missing data;
- selection or classification errors: where a double taxation agreement partner has either forwarded data that does not relate to Australian residents and/or classified Australian residents using the wrong country code; and

³⁸ This information is collected through Section A, Question 1, where industry code, amount and foreign location information is collected.

- numerical errors: for example, as previously indicated, in one instance amounts were overstated by a factor of 100, caused by the removal of the decimal point in data provided to the Tax Office.

2.66 The OECD recognises the importance of feedback from the receiving jurisdiction:

“Feedback to the sending country is essential to improve the efficiency of automatic exchange of information. Feedback from the receiving country on information exchanged automatically (not purely from an IT perspective) is crucial to make better use of what is exchanged: knowing what the source is of data exchanged, the common errors identified, etc. Feedback may also be useful to tax administrations for justifying resources for exchange of information.”³⁹

2.67 The Tax Office has provided a large number of TIES reports to DTA partners, and a sample of fifty four reports were examined by the ANAO. The reports were in the standard format as laid out by the OECD, providing considerable helpful information for the recipients.

2.68 The same level of formal feedback was not provided to the Tax Office from its DTA partners. Few formal feedback reports were provided and these were generally not in the OECD format. The Tax Office has highlighted the relevance of such reporting to OECD working parties during 2008.

2.69 Data quality reports which have been provided to Australia by DTA partners, commenting on the AEOI data which the Tax Office provides, identified:

- date of birth, which is likely to be important for identity matching, was missing. One report stated 97.5 per cent of records related to individuals yet date of birth information was present in only 25.3 per cent of instances⁴⁰; and
- Country of residence code not matching the physical data label of the data.

³⁹ OECD (2006), “*Manual on the implementation of Exchange of Information provision for tax purposes*”, part 4.

⁴⁰ This issue is an example of the base information not being available to the Tax Office at the time of collection.

2.70 Whilst the specific data quality feedback received through these interactions would have been of some value to the Tax Office, non-standardised modes of feedback are unlikely to provide the level of insight that a systematic reporting approach by DTA partners could provide. Consistent reporting provides a reliable basis for assessing improvements over time. The lack of such feedback to the Tax Office by DTA partners in relation to AEOI data reduces the opportunity for the Tax Office to improve the quality of the data it provides, if required.

2.71 Due to the small number of TIES reports received by the Tax Office it is difficult to arrive at an informed view of the quality and value of the AEOI data which Australia sends to its DTA partners. However, it was noted that the efforts of the Tax Office were appreciated by the overseas jurisdictions as reflected in correspondence.

3. AEOI Governance

This chapter provides an outline of DTA development processes and the Tax Office's governance arrangements for AEOI.

Introduction

3.1 At the international level, the OECD has developed model conventions and administrative standards which assist countries to negotiate DTAs and operate consistently with them.

3.2 Within the Tax Office, a number of functional areas and business lines contribute to the delivery of the AEOI program. The Tax Office has established committee structures to provide governance and coordination of this activity.

OECD contribution to DTA governance

3.3 The OECD has provided an important focus for the ongoing development of DTA activities. The development of a DTA model convention⁴¹ has been particularly important, providing a common starting point for negotiation between the parties. Additionally, despite being at a high level, the model convention provides the foundation for the development of consistent administrative procedures to assist inter-operability between jurisdictions.

3.4 Progressing issues in the international arena involves a considerable amount of operational level liaison work by the Tax Office in order to engender international consensus and cooperation, particularly amongst Competent Authority functions. The OECD contributes to the objective of arriving at consensus, providing a focus for debate and a structure within which the merits of competing ideas can be discussed and resolved.

3.5 A number of OECD documents assist the Tax Office at an operational level conduct its AEOI program:

- (a) the OECD publishes a range of documents significantly informed by individual input provided by member countries.⁴² Such documents

⁴¹ OECD Model Tax Convention on Income and on Capital.

⁴² An example publication is "Tax Co-operation 2009 – Towards a level playing field, 2009 assessment by the Global Forum on Transparency and Exchange of Information", OECD.

contribute to the Tax Office developing an informed understanding of the international tax administration environment;

- (b) a comprehensive “Manual on the Implementation of Exchange of Information Provisions for Tax Purposes”, which specifically covers AEOI;
- (c) standards including data interchange formats SMF and STF;
- (d) defined quality feedback reports (TIES report); and
- (e) OECD guidance on the selection of domestic experts contributing to international outreach and capability building programs.

3.6 The OECD Committee on Fiscal Affairs contributes to the setting of the associated standards to support DTAs. The Committee deals with issues including the Model Tax Convention and has a number of working parties, including:

- (a) Working Party 1: tax treaty issues; and
- (b) Working Party 8: enhancing co-operation to minimise the extent of tax evasion and avoidance.

3.7 In the AEOI context, the Tax Office has a particular interest in Working Party 8 and the Tax Information Exchange System (TIES) sub-group. This sub-group was established to focus on the more technical aspects of automatic exchange, including specification of interchange schema which led to the SMF and STF formats. This sub-group also has been responsible for the promulgation of PGP as a means of securely exchanging AEOI data. The Tax Office has provided delegates to attend this working party, and has also held the position of co-chair.

3.8 Involvement with the OECD provides the Tax Office with opportunities to influence the AEOI international agenda and practice.⁴³ On 24 September 2009, the Assistant Treasurer announced that Australia had been elected inaugural chair of the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes for a two year term. The announcement outlines two anticipated bodies of work which are likely to be particularly relevant to AEOI in the future:

⁴³ Such influence may extend to a range of operational areas, including, for example security interchange procedures.

"The Global Forum will then also develop an in-depth peer review system under which member jurisdictions will monitor and review progress made towards the implementation of international standards for exchanging critical tax information."

"The Global Forum will immediately identify mechanisms to speed-up agreements to exchange information and to enable developing countries to benefit from the new more cooperative tax environment."⁴⁴

Double tax agreement negotiation

3.9 The governance arrangements for DTAs adopted by Australia are modelled on the OECD Model Tax Convention⁴⁵ and supporting documentation. The use of the Model provides the benefit of an accepted international foundation for negotiation and customisation. The Model outlines a range of clauses enabling cooperative behaviours including information exchange designed to facilitate monitoring and investigations as well as providing for the transfer of taxation data for the purposes of preventing global tax evasion through voluntary (including AEOI) and obligatory (including Specific request) exchanges of information between tax administrations.

3.10 The OECD Model Convention on which Australian DTAs are based has changed over time in response to the need to adapt to international and domestic taxation collection administrative practices.⁴⁶ More recently, Australian DTA treaties reflect greater international cooperation in tax matters, and may include clauses on international assistance in collection of taxation debts.

3.11 The text of DTAs is necessarily broad and provides administrative flexibility; DTAs are renegotiated infrequently and need to be functional as domestic tax administration law evolves. In some cases treaties have not been renegotiated for some time, up to 37 years as noted in Table 3.1 below.

⁴⁴ Senator the Hon. Nick Sherry, Media Release "*Australia Elected Chair of Global Forum*", 24/9/2009.

⁴⁵ OECD Model Tax Convention on Income and on Capital.

⁴⁶ The Model Tax Convention was first published in 1958 by the Organisation for European Economic Cooperation (OEEC, which subsequently became the OECD). Source: <www.oecd.org>.

Table 3.1

Australia's oldest DTAs.

Double Taxation Agreement partner	Age (years)
Netherlands	23
Malta	25
Ireland	26
Italy	27
Korea (republic of)	27
Sweden	29
Denmark	29
Switzerland	30
Philippines	30
Germany	37

Note: Treaty age has been based on the date of signature of the treaty last amended. A census date of 1 November 2009 has been used for date calculation purposes.

Source: <www.treasury.gov.au>, with ANAO analysis.

3.12 DTA renegotiations take considerable time, and adding protocols to a DTA to extend its value to Australia and its DTA partners will not necessarily require re-negotiation of the full DTA document. For efficiency, jurisdictions understandably do not enter into a lengthy re-negotiation of DTA documents unless there is a considerable benefit for the effort required.

3.13 The Treasury manages the DTA negotiation process on behalf of the Government as well as providing advice to the Government on DTA matters. The Tax Office provides advice on revenue collection administration to Treasury and through it the Government. It remains a decision for the Parliament as to whether a DTA or a DTA amendment is in the national interest.

Legislation

3.14 DTAs are enacted through the *International Tax Agreements Act 1953* (Cth) (the Act)⁴⁷; each new agreement forms a schedule to the Act. As each agreement is the product of negotiation between sovereign powers there is not

⁴⁷ The ITAA may be examined in full at <www.comlaw.gov.au>.

strict uniformity between DTAs, though similarities far outweigh differences. The Act contains clauses which address:

- withholding tax;
- taxation of dividends;
- the gathering and exchanging of information; and
- the relief from double taxation where profits are adjusted.

3.15 The schedules of the Act contains the text of the agreed DTAs. Administrative decisions based on DTAs require a degree of familiarity with specific DTAs. For example, some DTAs contain an Assistance In Collection clause which enables the Tax Office to request a foreign tax administration to collect funds on Australia's behalf using the full force of that jurisdiction's domestic law in the jurisdiction concerned, and remit recovered monies to the Tax Office.

Automatic Exchange of Information Steering Committee

3.16 A number of business lines and functional areas within the Tax Office contribute to the management and use of AEOI. These areas are principally in the compliance area of the Tax Office, and include active compliance, coordination, risk management and technical functions.

3.17 The International Relations Section of the Large Business and International business line performs a coordination function and is the interface, through Competent Authorities, with international DTA partners.

3.18 In 2006 an internal review recommended "an Automatic EOI Steering Committee be formed with SES membership from the key stakeholders to provide a "whole-of-ATO" leadership approach (both strategic and operational) to the ATO's Automatic EOI Program".⁴⁸

3.19 Following this recommendation, the Automatic Exchange of Information Steering Committee Charter was finalised on 1 August 2006, specifying the following responsibilities:

⁴⁸ Review of Australia's Automatic Exchange of Information Program, September 2006.

- (a) Enhance, guide and influence the direction and priorities of the stakeholders involved in the Automatic Exchange of Information Program;
- (b) Provide strategic leadership and direction on the Automatic Exchange of Information program to all relevant Tax Office areas;
- (c) Drive and evaluate the effectiveness of the Tax Office's Automatic Exchange of Information Program;
- (d) Develop measures of success linked to the business outcomes we require in this area and design our strategies to achieve them;
- (e) Understand and interpret at the strategic level the Automatic Exchange of Information Program;
- (f) Engage and communicate with key stakeholders on the Automatic Exchange of Information Program;
- (g) Influence the resources that are applied to the Automatic Exchange of Information Program;
- (h) Monitor and report on Automatic Exchange of Information Program aspects of the Compliance Program; and
- (i) Support the development and maintenance of the appropriate Tax Office internal capability as it relates to the Automatic Exchange of Information Program.

3.20 Membership of the Steering Committee included officers with responsibility for International Relations, Micro Enterprises and Individuals, Small and Medium Enterprises, Lodgement Compliance, the Corporate Intelligence Unit and the Data Matching and Integrity Team.

3.21 Meetings of the Steering Committee occurred on a typically bi-monthly basis, but were more frequent initially when the committee was particularly focussed on progressing an internal review of the AEOI function within the Tax Office.

3.22 The minutes of these meetings indicated that the Steering Committee provided an important focal point to discuss problems, compliance activities and incremental advancements in AEOI. Individual compliance exercises were discussed and outcomes recorded in considerable detail.

3.23 The Steering Committee provided a vehicle for progressing the recommendations of an internal review of the AEOI function. The committee was aware of risks, including operational data integrity issues, data availability and areas for improvement.

3.24 As reflected in the minutes, a considerable proportion of the Committees' time consisted of seeking incremental improvement in AEOI data coverage. Additionally, the Committee sought to encourage better use of the available AEOI data resource through compliance exercises.

3.25 The Steering Committee did not have authority to direct areas within the Tax Office to undertake particular activities. The ability of the Committee to exercise leadership on issues relating to AEOI relied upon consensus. A positive indicator of the effectiveness of the committee in providing strategic direction is the increasing number of compliance exercises since the committees' inception.

3.26 The compliance activities conducted by the Tax Office are considered in more detail in Chapter 5.

Exchange of Information Advisory Committee

3.27 On 22 December 2008, the Tax Office changed the role of the AEOI Steering Committee; increasing the breadth of its responsibilities to include all internationally exchanged information under Australian DTA arrangements, not just AEOI.

3.28 The Charter for the Advisory Committee was later approved on 1 April 2010. The increase in scope of the committee, beyond AEOI, may provide a more appropriate governance structure given the broad spectrum of information exchange activity.

3.29 The updated Charter provides a high degree of flexibility to the chairperson of the committee. The ANAO notes that whilst the previous AEOI Steering Committee Charter was specific in stating the responsibilities of the committee at an operational/deliverable level, the updated Charter is a more strategic level document, placing greater emphasis on the role of the chairperson in establishing the committee's agenda. To assist accountability and understanding, it would be useful for the new EOI Advisory Committee to communicate its priorities to all stakeholders within the Tax Office.

4. Information Security and Privacy

This chapter considers the security and privacy implications of the Tax Office's management of the AEOI program.

Introduction

4.1 As a consequence of the AEOI program exchanging large volumes of taxpayer information across international borders, the security protections put in place to minimise the risks of data loss or unauthorised access are important. Should AEOI data security be compromised and security procedures not be robustly defensible in the public arena there is a significant reputational risk to the Tax Office and ongoing participation in the AEOI program may be challenged.

4.2 There have been occurrences overseas where data loss by government agencies has resulted in embarrassment. These events have widely reported in the press⁴⁹ and resulted in public inquiry.⁵⁰

4.3 The Tax Office, on becoming aware of these overseas events, announced in December 2007 that a consultant would undertake a review of data security practices generally within the Tax Office.

⁴⁹ See <<http://news.bbc.co.uk/2/hi/7104945.stm>> and <<http://news.bbc.co.uk/2/hi/7103566.stm>> [accessed 29 April 2010].

⁵⁰ Independent Police Complaints Commission (2008), "IPCC independent investigation report into loss of data relating to Child Benefit", United Kingdom. In its 25 June 2008 press release, the IPCC made the following comments "The IPCC's investigation uncovered failures in institutional practices and procedures concerning the handling of data. It revealed the absence of a coherent strategy for mass data handling and, generally speaking, practices and procedures were less than effective. The IPCC found that there was: a complete lack of any meaningful systems; a lack of understanding of the importance of data handling; and a 'muddle through' ethos. Staff found themselves working on a day-to-day basis without adequate support, training or guidance about how to handle sensitive personal data appropriately."

The full report is available at:<http://www.ipcc.gov.uk/final_hmrc_report_25062008.pdf> [accessed 29 April 2010].

Information Security Practice Review

4.4 The review of data security commissioned by the Tax Office resulted in a report entitled “Australian Tax Office – Information Security Practices Review” (IT Security Review), dated April 2008.⁵¹ Its scope included:

- current protections, policies, practices and assurance processes;
- how the office compares with industry best practice;
- the effectiveness of staff awareness programs;
- classification of information;
- different work areas and their needs;
- emerging trends such as flexible, home-based working arrangements;
- the differences between electronic and paper forms of information, and
- protocols for the movement and exchange of information.⁵²

4.5 The report considered international data transfer operations which has implications for the management of AEOI data transfer by the Tax Office. The review found that information generally was exchanged without a consistently applied security mechanism to guard against unauthorised disclosure or loss. More specifically it noted that the international transfer of classified information did not always use appropriate encryption. Data was transferred on physical media such as CD-ROM or electronically via e-mail. The report also noted that there are risks in providing general taxpayer information to third parties where there was limited or no assurance that the recipient will adequately protect the security of provided data in storage or in disposal.⁵³

⁵¹ <<http://www.ato.gov.au/content/downloads/COR138560InfoSecurity.pdf>> [accessed 29 April 2010].

⁵² *ibid.*

⁵³ DTAs include clauses concerning the protection of exchanged data. The following clause, as an example, has been extracted from Article 25 of the Australian-Canada DTA, which is contained in the *International Taxation Agreement Act 1953* (Cth), available via <www.comlaw.gov.au>: “Any information received by the competent authority of a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment, collection or enforcement of the taxes to which this Convention applies, or with the determination of appeals in relation thereto, and shall be used only for such purposes.”

Australian Government information security requirements.

4.6 The minimum security standards which the Tax Office is required to meet are outlined in:

- The Protective Security Manual (PSM), published by the Attorney-General's Department⁵⁴; and
- The Australian Government Information and Communications Technology Security Manual (ACSI-33), published by the Defence Signals Directorate⁵⁵.

4.7 ACSI-33 states that:

"3.8.1.9 Encryption of data in transit can be used to provide protection for information being communicated over communication mediums and hence reduce the certification requirements of the communication medium".⁵⁶

4.8 The Tax Office classifies AEOI data at the IN-CONFIDENCE level. It is inappropriate to send IN-CONFIDENCE information over the UNCLASSIFIED Internet. However, the Tax Office may use the Advanced Encryption Standard (AES)⁵⁷ to apply additional protection to AEOI data to legitimately secure and send AEOI data via the Internet to DTA partners.

AEOI security characteristics

4.9 There are significant differences between security arrangements for incoming and outgoing AEOI data, as set out in Table 4.1, below:

⁵⁴ An outline of the PSM is available through the Attorney-General's Department website <www.ag.gov.au>.

⁵⁵ ACSI-33 is available at <www.dsd.gov.au>.

⁵⁶ ACSI-33, Part 3, p. 113.

⁵⁷ The Advanced Encryption Standard refers to an encryption algorithm. It is implemented in many open source and commercial encryption products. It is referred to in ACSI-33.

Table 4.1**Security characteristics compared for AEOI data received and sent by the Tax Office**

Characteristic	AEOI received by the Tax Office from DTA partners	AEOI sent by the Tax Office to DTA partners
Ability to exert management control	The Tax Office may influence but not control the security of information sent to it. The Tax Office can exert significant influence by requesting that insecure information not be sent to it.	The Tax Office determines the recipients of information and the form of security methods applied.
Complexity	The various DTA partners control how they send information to the Tax Office.	Singularly, the Tax Office may decide how it sends information to all DTA partners.
Expectation of AEOI focus	AEOI is expected to relate to Australian residents.	AEOI is expected to relate to residents of the recipient DTA partner.
Security tools used	PGP, WinZip, Securezip, Guardianedge removable storage encryption.	PGP, WinZip
Unencrypted data	There have been instances where the Tax Office has received unencrypted data. Data has been transported via post or hand delivered.	There have been instances where the Tax Office has sent unencrypted data. Data has been transported via post or hand delivered.
Visibility of encryption method applied	Problematic. Visual inspection of data and password recovery tools may provide visibility. Practically, the Tax Office relies on advice provided with the data, which rarely includes advice on the encryption method used.	The Tax Office controls the process by which data is encrypted and has complete visibility.
Reputation risk to the Tax Office in the event of AEOI compromise	Risk: that data in respect to Australian residents is lost. The level of reputational risk to the Tax Office will be influenced by where the loss occurs, public interest, media coverage and ability of the Tax Office to defend its AEOI data protection policies including efforts to define responsibility and improve security practices leading up to the loss event.	Risk: that data in respect of overseas residents is lost. The level of reputational risk to the Tax Office will be influenced by where the loss occurs, public interest, media coverage and ability of the Tax Office to defend the AEOI data protection procedures it adopts and associated outcomes.

Source: ANAO.

Unencrypted data transfer

4.10 The ANAO noted a small number of instances in the 2007 year where the Tax Office had sent and received AEOI data which was unencrypted. On the few occasions where this had occurred the Tax Office sent outgoing data via the postal mail system⁵⁸ or through personal exchange with officials from the receiving jurisdiction⁵⁹.

4.11 The Tax Office relies on arrangements outside of its direct control to both send and receive information. For example, information delivered by post may be lost, and information sent via diplomatic resources may be misplaced. Because there is the possibility of human fallibility or unexpected behaviours, and the business impost of using encryption is so low, strong encryption should be used to secure AEOI data in transit.

Encryption tool usage

4.12 The Tax Office uses two principal encryption products when sending AEOI data; Pretty Good Privacy (PGP) and WinZip. The Tax Office uses, in very limited circumstances, other encryption products to decrypt information, depending on the products used by DTA partners.

4.13 WinZip is primarily an archiving program which compresses data to provide storage and transmittal efficiency. However, WinZip also has the ability to password encrypt the data archives it produces with user-selectable encryption methods of varying strengths as follows;

- (a) “Standard 2.0 Encryption” – is a legacy form of encryption which provides backward compatibility to earlier versions of WinZip. This encryption method is not recognised in ACSI-33 as appropriate to protect IN-CONFIDENCE information prior to sending via the Internet; and
- (b) Advanced Encryption Standard (AES 128/256). This encryption method is recognised in ACSI-33 as appropriate to protect IN-CONFIDENCE information prior to sending via the Internet.

⁵⁸ That is, protection through obscurity.

⁵⁹ That is, protection through heightened control of the transmission method which is trusted.

4.14 WinZip has a high degree of flexibility which is appropriate to a consumer product but is less than ideal when being relied upon to mitigate security risks by the Tax Office in their specific application and risk context. The flexibility available in WinZip permits a user to select which method of encryption to use, AES or “2.0” encryption algorithms.

4.15 The characteristics of the two major encryption tools used in AEOI data transfer are outlined below, see Table 4.2.

Table 4.2

AEOI encryption programs compared

Encryption tool	Encryption algorithm	Tool configuration allows encryption algorithm enforcement	Tool configuration allows password complexity enforcement
WinZip	AES “2.0” a legacy algorithm not approved by ACSI-33.	WinZip allows the user to set a default algorithm. This is able to be changed by the user.	Yes, but this is able to be changed by the user.
		The configuration is not able to be locked by an administrator.	
PGP	AES	The encryption algorithm is defined by the recipient of the data when their private key is generated and the public key distributed to the sender. The encryption algorithm is unable to be re-defined by the sender.	Not relevant. PGP uses the public key of the receiver instead of a password to encrypt data. Passwords are used, but as part of authentication not as a determinant of encryption strength.

Source: ANAO examination based on manufacturers website and program testing where possible.

4.16 The Tax Office relies upon the correct use of WinZip and PGP to secure both incoming and outgoing data. Both programs are capable of encrypting data with the Advanced Encryption Standard (AES) encryption algorithm. However, to achieve adequate data protection, adherence to clear and easily understood procedures is very important.

4.17 The Tax Office advised that when sending 2007 data (in 2008) that it used a mixture of both PGP and WinZip, depending on the preference of the receiving DTA partner. Approximately 80 per cent of this data was encrypted using PGP, but 77 per cent of DTA partners received Australian AEOI data encrypted with WinZip, see Table 4.3, below:

Table 4.3

Encryption program usage

Encryption program	Number of countries to which data sent	Number of records sent
WinZip	27	383 591
PGP	8	1 452 011

Source: Tax Office,

4.18 With WinZip, inappropriate disclosure of the password means that the encrypted data is compromised. This is not the case with PGP; decryption also requires possession of a private-key, which the receiver of the data, not the sender, secures. Additionally, PGP derives its cryptographic strength from a computer generated public/private key pair of a complexity and length which is significantly greater than a normal password approach. PGP is a more complex encryption technology to that employed by WinZip, but the additional complexity is outweighed by security advantages in the context of the Tax Office’s application.

Password usage

4.19 The protections afforded by WinZip depend upon the appropriate selection of a password during the encryption operation. Inappropriate (short and non-complex) encrypted AEOI data archive passwords can be compromised quickly through a “brute force attack” using software freely downloaded from the Internet. To demonstrate password complexity, passwords were categorised in terms of the character sets they used. Those passwords with greater number of characters in the total character set are more complex, and harder to compromise, as Table 4.4, below, demonstrates:

Table 4.4**Actual and estimated⁶⁰ WinZip password recovery times**

Number of characters	Lower or upper case	(Lower or upper case) and numbers	Lower and upper case	Lower and upper case and numbers	Lower and upper case and numbers and "other"
6	19 minutes (actual)	2.10 hours (actual)	20 hours (estimated)	2 days (estimated)	35 years (estimated)
7	8 hours (estimated)	2 days (estimated)	6 weeks (estimated)	21 weeks (estimated)	see Note 1
8	1 week (estimated)	17 weeks see Note 2	6 years (estimated)	25 years (estimated)	see Note 1
9	32 weeks (estimated)	11 years (estimated)	320 years (estimated)	see Note 1	see Note 1
10	16 years (estimated)	411 years (estimated)	see Note 1	see Note 1	see Note 1
11	413 years (estimated)	see Note 1	see Note 1	see Note 1	see Note 1
12	see Note 1	see Note 1	see Note 1	see Note 1	see Note 1

Note 1: The recovery times are significant and offer a high degree of protection.

Source: ANAO analysis.

4.20 The WinZip password complexity and lengths used in AEOI data transfers to and from the Tax Office in 2008 and early 2009 were obtained from Tax Office files and summarised in Table 4.5.

⁶⁰ This estimate is generated by the program used to recover WinZip passwords. The estimation reflects the time to test all possibilities based on the number of possible characters. Because the program attempts one password after another, actual recovery times may be less but are unlikely to be significantly more. The ANAO could not locate on the Internet a program which claimed to be able to compromise data encrypted with PGP.

Table 4.5

Observed WinZip frequency of password usage

Number of characters	Lower or upper case		(Lower or upper case) and numbers		Upper and lower case		Lower and upper case and numbers		(Lower or upper case or numbers) and "other" ⁶¹	
	TAX ⁶²	OS ⁶³	TAX	OS	TAX	OS	TAX	OS	TAX	OS
6			14	2					4	
7		2					1			
8				1				1		
9		2								1
10			1	1			1			2
11								2 ⁶⁴		
12										1
13			5							7
14										3
15										1
16								1		
20										2

Source: Tax Office, with ANAO analysis.

Note: This is not a fully reconciled analysis. Given the chronological organisation of historical AEOI files, a full reconciliation is not practical. The analysis is indicative of practices in operation at the time. Passwords which contained "other" characters have been grouped for simplicity in the table above. This reflects the probability that a user selecting "other" characters will create more complex passwords. In the passwords examined, those which used "other" characters were the mostly highly complex.

4.21 The Tax Office used the same password multiple times for data sent to different DTA partners; one password was used five times, another fourteen, another four. As a result of this practice, if a data file is sent to the wrong DTA partner it can be opened by an inappropriate recipient with the Tax Office

⁶¹ In terms of complexity, passwords with "other" characters have been assumed to contain all possible characters, reflecting likely use of password recovery software and to simplify presentation.

⁶² Denotes the Tax Office sending AEOI data.

⁶³ Denotes overseas country which sent AEOI data to the Tax Office.

⁶⁴ Password was used twice by the same country.

supplied password. The ANAO found no evidence from a review of the Tax Office files that this had actually occurred.

4.22 Both the Tax Office and overseas jurisdictions on occasion base the elements of the password used on the subject being encrypted. This practice weakens security by providing character groups which can be used to shorten the period of time required to conduct a brute force password attack. Security would be enhanced if there was no relationship between the data being sent and the password used.

4.23 The Tax Office provided guidelines to staff on appropriate password length and construction. The Tax Office recommended at least six characters with a mix of character types to increase complexity and create a strong password. This guidance was developed for staff to use for general login circumstances.⁶⁵

4.24 Over the course of the audit the Tax Office provided additional local guidance to relevant staff to increase the minimum password length for encrypting AEOI data using AES, to a minimum of eight characters with maximum character complexity. On the basis of the estimation technique used in Table 4.4, above, a password of this length provides for a significantly reduced risk of inappropriate disclosure to the Tax Office. The Tax Office also upgraded WinZip to the latest version to take advantage of a new password length/complexity configuration feature.

AEOI security practice

AEOI sent to the Tax Office by DTA partners

4.25 The Tax Office does not control but has influence over the security methods applied to the AEOI data received from DTA partners. There is a risk that where WinZip is used there is a possibility that poor training or human error may result in inappropriate use. Should this occur, AEOI data sent by overseas DTA partners may not provide adequate protections.

⁶⁵ A computer logon environment generally requires a shorter, less complex password, particularly as it is expected that passwords must be able to be remembered. Additional protections are also available in a network environment, which are not available in the AEOI data archive context, such as only allowing a specified number of logon attempts before the user account is frozen. In contrast, should an AEOI data archive fall into the wrong hands an attack may be made with an infinite number of password attempts until success is achieved.

4.26 The level of risk which the Tax Office is exposed to could be minimised if the receiver is able to define the encryption technology used. In respect of data encrypted with WinZip, the risk of a using weaker encryption may be reduced by the Tax Office frequently reinforcing that only the AES encryption algorithm should be used when sending data to the Tax Office. Given the Tax Office's application, adopting PGP as the default encryption technology would be advantageous as risks relating to training and human error would be minimised.

AEOI stand-alone computing environment

4.27 The Tax Office uses a standalone computer for en/de-encrypting AEOI files. This standalone computer is also used to send/receive data internationally.

4.28 At the commencement of this audit the standalone machine was not appropriately secured, with user access permissions set at a higher level (Administrator) than required. The Tax Office addressed this issue prior to the end of the audit.

4.29 At the completion of this ANAO audit the Tax Office continued to explore methods of providing additional security and incorporate AEOI data encryption into the Tax Office environment in more integrated ways and utilise hardware based encryption technologies to further improve security outcomes.

4.30 Additionally, in response to the Information Security Practices Review (see paragraph 4.4) the Tax Office instituted an implemented an Information Security Risk Manager (ISRM) role (except in the Compliance Sub-plan where it was trialled in four Business Lines). Its purpose is to provide additional assurance of the security procedures that are adopted where information, including AEOI data, is sent by the Tax Office to external recipients. The ISRM scheme was anticipated to reduce the likelihood of security risks eventuating, by providing managers with improved access to security advice, appropriate to the business context. The Tax Office has advised that this initiative will be continued and discussions are ongoing regarding implementation in the Compliance Sub-plan. The operational objectives of the ISRM scheme, as advised by the Tax Office are to provide:

- (a) "information security advice [to non security / IT staff], informed by an understanding of the business context, including in relation to data transfers and security classification;
- (b) assistance in the development of data transfer arrangements through the provision of information security risk assessments; and
- (c) reduced likelihood of information security incidents through strengthened security controls."⁶⁶

4.31 The Tax Office also instituted an Information Transfer Gatekeeper process from 22 October 2009, initially as a pilot to refine the necessary procedures. The Gatekeeper process, essentially providing a review and approval mechanism, is designed to mitigate against the loss of high risk data sets.

4.32 The Gatekeeper process is potentially an important mechanism to provide additional assurance to management that appropriate security practices are being observed at the data transfer interface for high risk transfers. Following an extended pilot period, the Tax Office advised that the Gatekeeper process, with some minor modification, would continue.

4.33 Given the timing of its introduction, the effectiveness of the Gatekeeper process and the Information Security Risk Manager role was not considered by the ANAO and it is premature to determine its effectiveness in terms of operational practices involving AEOI.

4.34 It is noted, however, that the Tax Office was pursuing improved security approaches prior to the commencement of this audit and has also improved security practices in response to this audit. As technological capability improves across the DTA network, opportunities to further increase the security of AEOI data transfer will reduce the risks of data loss or unauthorised access.

⁶⁶ Tax Office.

Privacy

4.35 The *Privacy Act 1988 (Cth)* documents the privacy obligations that are applicable to Australian Government agencies, including the Tax Office.

4.36 The Tax Office has legislative authority through the *International Tax Agreements Act 1953* to exchange information, including AEOI information, consistent with the Privacy Act.

4.37 The Tax Office has included in compliance plans, media releases, and its website information that indicates information is transferred to DTA partners; providing a reasonable opportunity for taxpayers to become aware that taxpayer information is transferred across international boundaries.

4.38 Whilst there was no evidence of a privacy breach, there is scope to increase the security applied in handling AEOI information, which would also reduce the risk of a privacy breach eventuating in the future.

5. AEOI usage in Compliance Activities

This chapter considers the Tax Office's use of identity matching to support AEOI data use, and, AEOI data use within compliance exercises.

Introduction

5.1 The scope of this audit specifically relates to, and draws conclusions on the use of AEOI data by the Tax Office. This Chapter focuses on compliance exercises conducted using AEOI data as an input, particularly for case selection. It is noted however that the AEOI data set does not of itself determine compliance activities of the Tax Office. Rather, risks are identified and a range of datasets are considered in the design of compliance exercises.

5.2 In this context, although AEOI data represents a relatively minor subset of the data which is available to inform risk assessment through compliance activity, this chapter makes observations about how AEOI data usage may be improved.

Compliance activities using automatically exchanged information

5.3 Since 2005 there has been an increase in the use of AEOI data as an initial case selection tool by compliance areas within the Tax Office in conducting compliance exercises, typically audits. The use of AEOI data by the Tax Office in compliance exercises has increased from a low base over the last five years.

5.4 To a significant extent, the low utilisation of AEOI data in compliance activities reflects difficulties which compliance areas experience in making effective use of the AEOI data; principally for the data quality reasons outlined in "Impediments to the effective use of AEOI" in paragraph 2.9.

5.5 Business line compliance areas have a responsibility to maximise the effective use of the resources at their disposal. Managers will rightly question if it is an effective use of limited resources to continue with a particular activity if there are alternatives which achieve greater outcomes whilst treating comparable risks, at lower cost.

5.6 Tax Office compliance areas generally considered that conducting compliance exercises informed by AEOI data created a non-quantifiable deterrent impact against taxpayers who would otherwise not meet their obligations.

5.7 At an operational level within the Tax Office, future decisions on the continued investment in compliance exercises informed by AEOI data, particularly for case selection purposes, is likely to be influenced by research into taxpayer voluntary compliance achieved and the Tax Office's judgement of AEOI effectiveness in addressing taxpayer behavioural risks. To this end, the 2009–10 Compliance Program⁶⁷ provides the Tax Office with considerable operational flexibility in the deployment of resources to address identified risks.

5.8 As noted above, AEOI data is just one of a number of different sources the Tax Office utilises for compliance work.⁶⁸ The details below compare the different methodologies the Tax Office employed to leverage the AEOI data source within the context of significant compliance exercises.

General observations

5.9 The efficient use of AEOI data for compliance activity requires that the Tax Office identity match the AEOI data to the Tax Office Tax File Number client register. All of the compliance exercises examined as part of this audit used AEOI data that utilised the Tax Office's identity matching capabilities to match the AEOI data to the Tax File Number client register.

5.10 The Tax Office has expanded AEOI compliance activities within various business lines, and as a result is better able to leverage staff knowledge of the use of AEOI data in specific taxpayer market segments, developed over time. The ANAO reviewed compliance exercises undertaken in the business line areas below.

⁶⁷ <<http://www.ato.gov.au/corporate/content.asp?doc=/content/00205435.htm>> [accessed 29 April 2010].

⁶⁸ Whilst AEOI data may be used for case selection, further data sources are used to clarify a taxpayer's obligations. The Tax Office considers that, AUSTRAC data is a complementary data source to AEOI data. Further information on AUSTRAC is available at <<http://www.austrac.gov.au>>.

Tax Practitioner and Lodgment Services (TPALS)

5.11 TPALS' role includes identifying and managing the risks of persons and entities not meeting their lodgment obligations. This includes Australian taxpayers who earn overseas income. TPALS uses AEOI data to assist in determining whether individuals and entities are required to lodge an Australian income tax return.

5.12 TPALS provided the ANAO with a Risk Context Statement, dated 18 November 2008. The document described how the menu of available TPALS business activities sought to address identified risks. The TPALS document was comprehensive and provided TPALS with an informed basis to consider future compliance exercises using AEOI data. TPALS did not construct a risk assessment document to inform lodgment enforcement activity undertaken during 2006–07 or 2007–08.

5.13 TPALS selected AEOI cases on the basis of four variables, including ability to gain a high confidence identity match, age, income level and Australian tax return lodgment history. In consideration of these variables, TPALS conducted exercises using AEOI data covering the 2005–2008 period, using these parameters, as summarised in Table 5.1, below.

Table 5.1

TPALS lodgment enforcement activity

Financial year of activity	Number of cases actioned	Financial year of source data	Average change in tax
2006–07	435	2005–06	\$1 733
2007–08	76	2006–07	\$10 789
2008–09	477	2007–08	\$2 190
Total	988	-	\$2 650

Source: Tax Office.

5.14 TPALS commenced lodgment enforcement activity against 988 cases, resulting in 377 additional taxpayers, 38.2 per cent of the original case selection pool, meeting their obligations. The Tax Office assessed that the remaining 611 cases did not need to lodge a tax return.

5.15 The number of cases examined in 2007–08 was lower than other years for a range of operational reasons, including:

- (a) delays in actioning cases caused through the project implementation of a new case management system⁶⁹;
- (b) some of the available cases were not of sufficient quality for lodgement enforcement action. This reflects the inconsistent value of the AEOI data that is provided by DTA partners;
- (c) lower than anticipated availability of data to meet the performance targets; and
- (d) management decisions to defer some 2007–08 activity to the 2008–09 period in order to meet other 2007–08 performance targets.

5.16 Of the compliance exercises using AEOI conducted by the Tax Office, TPALS achieved the highest efficiency; with the Tax Office advising a return of approximately \$7.50 for every \$1 spent in direct costs. Despite this, TPALS noted it did not complete as many cases as originally planned and the revenue raised was below expectations. Additionally, cases selected through analytical models were significantly more effective at addressing risks than AEOI cases selected with AEOI data. As a result of this, TPALS re-considered its business approach with a stronger focus on addressing risk.

5.17 TPALS did not conduct a formal evaluation of their use of compliance exercises informed by AEOI data. However, TPALS analysed the methodologies they applied, resulting in updated ways of using AEOI data. As a result of this consideration, TPALS anticipates adopting a quantitative risk model based approach in the future.

5.18 This new risk model approach will consider AEOI data and action cases which are identified as being high risk, with the pre-condition that data has already achieved a high confidence identity match. For example, the previous parameter based model, which informed the lodgement enforcement activities in Table 5.1, considered four variables, whereas the proposed risk based analytical models interact with approximately thirty variables, providing TPALS with a more granular case selection capability and improved opportunities for further methodological refinement.

⁶⁹ A new organisation wide system being implemented in the Tax Office designed to introduce efficiencies in work allocation, client management and administrative practices.

5.19 The inclusion of AEOI data as an input in the risk based analytical model is anticipated to provide a useful basis to consider the utility of AEOI data, in the context of other data available. Importantly, the approach is expected to result in TPALS using its resources more effectively.

Micro Enterprises and Individuals

5.20 The Micro Enterprises and Individuals business line area had undertaken and documented a comprehensive risk assessment, demonstrating an understanding of the risks in the market segment, including trends in reporting different types of income and recognition of key compliance risks. The risk assessment informed the activities considered below.

Micro Enterprises

5.21 The compliance risk assessment concluded that the overall risk rating for taxpayers with offshore activities operating in this market segment was “high”, given:

“... the growing opportunities for accessing foreign income, the new mediums for undertaking transactions and the lack of information and understanding about these generally”.⁷⁰

5.22 One of the risks that the compliance risk assessment identified within the micro enterprises market was described as:

“Micro entities with international transactions ...fail... to report the transactions and/or the income to Australian authorities. This threatens the ability of the Australian authorities to confidently estimate the effect of globalisation on the Australian revenue base, potentially reduces Australia’s revenue base, and has an effect on community confidence in the tax system.”⁷¹

5.23 In responding to the identified risks, a methodology was designed based on a representative subset of AEOI data in order to reach a conclusion on the utility value of AEOI data, whilst also applying that data to generally identified risks. The results from the exercise were intended to inform future consideration of the allocation of resources in compliance activities using AEOI data.

⁷⁰ Micro Enterprises and Individuals Compliance Risk Assessment, “Internationals risk in the Individuals and Micro markets, p.32.

⁷¹ Treatment Strategy Plan – Internationals, Micro Enterprises and Individuals, p. 4.

5.24 To conduct this exercise AEOI data from the United States, Canada and New Zealand was selected, as data from these sources provided the majority of reported transactions for micro enterprise businesses within the set of available AEOI data. The ANAO notes that some of the data selected for compliance work was later found, through compliance work, to be problematic due to a decimal point error problem.

5.25 Based on cases selected, 82 per cent of micro enterprises had returned their foreign source income appropriately. However, some cases were only selected for compliance examination because there were shortcomings in the quantity and appropriateness of information provided by taxpayers.

5.26 The Tax Office issued 17 amended assessments; 10 per cent of the initial cases selected. The total income tax liability raised from these amendments was \$581 612. However, there was one significant outlier case which resulted in an income tax liability of \$531 847; excluding this case, the average adjustment was \$3110.

5.27 Through a process of elimination, as detailed in Table 5.2, below, the compliance exercise commenced with a significant set of data but eventually selected less than one per cent of original cases for compliance audit.

Table 5.2**Micro Enterprises AEOI compliance exercise case selection**

Analytical rationale	Cases
Initial pool of cases from 10 DTA partners, including companies, partnerships, superannuation funds and trusts	9 448
All entities other than companies removed. Trusts were excluded after sampling indicated that the number of suitable trusts, excluding entities already under compliance management in the Tax Office, would be too small to draw a meaningful conclusion. Partnerships were removed as they are not a taxing point. Superannuation funds were also removed.	-5 139
High quality data selected (New Zealand, Canada or the United States of America data remained). Others excluded.	-91
Remove companies where foreign source income is not above a reasonable threshold. This was done to facilitate a reasonable outcome against anticipated staff time investment. Remove companies which are the responsibility of the High Wealth Individuals business line.	-4 132
Income returned correctly or minor discrepancy	-69
Remove companies which are the responsibility of the Small and Medium Enterprises (S&ME) business line.	-2
Business was insolvent	-2
Income was declared through a trust	-2
Non-resident	-1
Not assessable (Section 23AJ <i>Income Tax Assessments Act 1936</i>)	-1
Incorrect entity identified	-1
Remaining	8
Voluntary disclosures made by the taxpayer	-7
Early exit from compliance exercise - a restricted access taxpayer.	-1

Source: ANAO analysis of Tax Office information.

5.28 The team within the Tax Office considering the compliance efforts outlined above made two recommendations:

- (a) that micro enterprises AEOI based active compliance ceases, and that consultation occurs with other areas to improve the collection and matching of OECD data from DTA partners with the objective of identifying improvements in case selection informed by AEOI data in the future; and

- (b) that an education strategy be developed to advise resident taxpayers that they must include income from all sources within Australia and overseas, and, how taxpayers can claim foreign tax credits.

5.29 Further to the above, at the time of conducting this ANAO audit, preliminary work within the Tax Office had commenced on a major education strategy. Minor education activities had already occurred including amending information materials provided to Australian immigrants to alert them to how the Australian tax system functions and, specifically, their obligations to declare all income including that derived from foreign sources. Additionally, some outreach material has also been provided to Tax Agents.

Individuals

5.30 The Individuals market segment utilised AEOI data through three exercises in successive years from 2004–05. Because there were multiple exercises which used the AEOI data, there was an opportunity to build on previous experience by investigating and seeking to improve methodological practice. Table 5.3, below, outlines the difference in approach in the two most recent years.

Table 5.3

Individuals foreign source income active compliance exercises case selection

	Strategy year	
	2005–06	2006–07
Main features	<ul style="list-style-type: none"> • AEOI data utilised for 5 jurisdictions. • Primary focus was foreign interest income. • Case selection performed by work area. • All cases were audits. 	<ul style="list-style-type: none"> • AEOI data utilised for 12 jurisdictions. • Analysed 13 income types • Examined the feasibility of a fully automated process. • Case selection performed by risk management areas using database enabled methods. • Focused on review work as testing quality of information.
Differences	<ul style="list-style-type: none"> • Manual case selection via excel spreadsheet by Active Compliance. • Staff knowledge limited to select jurisdiction and income types. 	<ul style="list-style-type: none"> • developed a tool to better present raw data and identify non-compliant taxpayers. • Casework refined through data interrogation to better refine selection approach. • Staff knowledge base increased to accommodate expanded complexity of DTA partner data types of income.

Source: Tax Office with ANAO analysis.

5.31 The compliance approach evolved to include three compliance strategies as detailed below:

- (a) compliance audit, which was a constant throughout all exercises;
- (b) a pre-lodgement advisory letter (from 2005-06) to encourage taxpayers to self assess their obligations appropriately. One of the functions of an advisory letter is education; seeking to reduce the risks of inappropriate self assessment by taxpayers as a result of a lack of familiarity with Australian taxation law. The advisory letter strategy has a number of advantages, some of which are particularly beneficial in the AEOI context:
 - relatively inexpensive;
 - less susceptible to the problems identified in “Impediments to the effective use of AEOI” (see paragraph 2.9);

- taxpayers who receive a letter may return an adjustment to the Tax Office;
 - the Tax Office has an informed view of how taxpayers should respond. Those taxpayers who do not respond appropriately can still be audited; and
 - even if there is no interaction, it is possible that there may still be an education and compliance benefit reflected in future taxpayer compliance; and
- (c) reviews (from 2006–07), were designed to provide a more in-depth understanding of the AEOI data and enable the Tax Office to explore the possibility of increased automation.

5.32 As reflected in Table 5.4 below, the “average change in tax” decreased for successive pre-lodgement advisory letter exercises, but the number of voluntary disclosures increased, reflecting the Tax Office’s desire to maximise voluntary compliance.

Table 5.4

Individuals active compliance pre-lodgement advisory letter exercise

Year of compliance exercise	Number of letters sent	Voluntary disclosures received	Adjustment rate	Average change in tax
2005–06	4500	911	20%	\$1031
2006–07	5500	1390	25%	\$463

Source: Tax Office.

5.33 Table 5.5, below, indicates that whilst there was an increase in audit outcomes in the 2006–07 financial year, there were fewer cases. Whilst reviews in 2006–07 were able to provide greater average outcomes they had a lower strike rate compared to audits. There has, however, been an increase in the average change in tax achieved since the 2004–05 exercise, but there is still significant variation between years in terms of percentage of adjusted cases and average change in tax. This has implications for audit managers prospectively planning to allocate resources as outcomes have a high degree of

unpredictability⁷² which may undermine a future decision to use AEOI data to address identified risks.

Table 5.5

Individuals AEOI active compliance exercise results

Year of compliance exercise		Number of cases completed	Number of cases adjusted	% rate of adjusted cases	Average change in tax
2004–05	Reviews	-	-	-	-
	Audits	1568	992	63%	\$1332
	Total	1568	992	63%	\$1332
2005–06	Reviews	-	-	-	-
	Audits ¹	1212	548	45%	\$3691
	Total	1212	548	45%	\$3691
2006–07	Reviews	295	12	4%	\$4881
	Audits	115	78	68%	\$2591
	Total	410	90	22%	\$2896

Note: Total excludes voluntary disclosures received as a result of pre-lodgement advisory letters. These have been shown in Table 5.4.

Source: Tax Office.

5.34 The Tax Office informed the ANAO that during 2006–07 it was unable to complete all the planned audit program as a result of reduced capacity of the Tax Office audit team due to:

- (a) training and systems issues resulting from the transition to a new case management system;
- (b) lead times to skill new staff in foreign income taxation issues; and
- (c) unavailability of staff for various periods significantly reducing the capacity of the small team undertaking the work.

5.35 The Tax Office advised that the total revenue gain from the three exercises depicted in Table 5.5 was \$ 3.6 million.

⁷² Variability may be caused by a range of factors including variable AEOI data between countries, inter-year variability, case selection and impacts of particular variables on international data, for example, exchange rates during periods of high volatility.

5.36 The Tax Office prepared a final report at the conclusion of the project and concluded: “Foreign source income should continue to be an area of focus”, noting the opportunities available to address non-compliance in international markets.

Large Business and International (LB&I)

5.37 At the time of undertaking ANAO audit fieldwork the LB&I business line, which includes the large business market segment, had not undertaken a structured compliance exercise using AEOI data. Specific information exchange requests are more likely to be used and JITSIC⁷³ arrangements may be utilised. Additionally, cash flows between multi-national entities are likely to be visible through AUSTRAC data.

Small and Medium Enterprises (S&ME)

5.38 The S&ME business line has conducted two exercises using AEOI data; in 2008 focussing on enterprises with turnover between \$2 and \$100 million, and, in 2009 on enterprises with turnover between \$2 and \$250 million.

5.39 In conducting the 2008 exercise the Tax Office had two objectives, being the exploration of data utility, and evaluation of taxpayer compliance. The Tax Office advised that the exercise:

“...was initiated to determine the effectiveness of the data and the level of compliance by entity taxpayers with respect to the reporting or under-reporting foreign source income in their income tax returns during the 2004 and 2005 calendar years, with a focus on dividends, royalties, interest, capital gains and other income”.⁷⁴

5.40 In 2009, a further compliance exercise was conducted, using AEOI data from 2006–2008, which was designed to evaluate taxpayer compliance and evaluate the usefulness of the AEOI data with respect to non-individual entities. The similarities and differences between the two exercises are depicted in Table 5.6, below.

⁷³ The Joint International Tax Shelter Information Centre (JITSIC) was established in 2004 by the tax administrations of Australia, Canada, the United Kingdom and the United States, to supplement their ongoing work in identifying and curbing tax avoidance and shelters and those who promote them and invest in them. Through JITSIC, timely specific Information exchange occurs consistent with the provisions of bilateral tax conventions.

⁷⁴ Source: Tax Office communication to the ANAO.

Table 5.6

Comparison of S&ME foreign source income active compliance exercises using AEOI data

	Strategy year	
	2008	2009
Main features	<ul style="list-style-type: none"> • 50 cases actioned, out of 93 identified. Case pool consisted of companies, trusts and superannuation fund entities. 	<ul style="list-style-type: none"> • 45 cases actioned, out of 106 identified. Case pool consisted of companies only.
Differences	<ul style="list-style-type: none"> • \$2-\$100 million turnover • Dual purposes – data engagement and promoting voluntary compliance. • Compliance conducted against 2003–04 and 2004–05 tax returns. 	<ul style="list-style-type: none"> • \$2-\$250 million turnover¹ • Promoting voluntary compliance, awareness and risk determination. • Compliance conducted against 2005–06 tax returns.

Note 1: The target market parameter increased as a result of business line responsibility changes.

Source: Compiled by the ANAO from Tax Office information.

5.41 In both the 2008 and 2009 exercises, a large proportion of the cases were assessed as requiring no further action; 30 cases (60 per cent) in 2008, and 41 cases (91 per cent) in 2009. The major reason for cases requiring no further action was that the Tax Office analysis confirmed that taxpayers had reported data incorrectly, for example recording income against the wrong question in a return. There were also instances where discrepancies were created through financial year non-alignment between the Australian and AEOI data financial year. When the Tax Office conducted further examinations it became satisfied that any debts were less than initially anticipated or small enough that they were not economic to pursue.

5.42 Overall, revenue gain as a result of S&ME compliance exercises using AEOI data was low, see Table 5.7, below.

Table 5.7

S&ME active compliance exercise outcomes

2008 exercise	2009 exercise
2 cases with voluntary disclosures of \$32 769	The Tax Office identified 3 amendment cases which resulted in \$230 000 of dividends being declared, a tax credit of \$22 000 being recognised, and an entity receiving a tax reduction of \$77 000.
1 case escalated to audit with an amount of \$128 362 plus foreign tax paid of \$19 254 in dispute.	1 case escalated to general compliance for further action.
1 entity where residency is being investigated further with a DTA partner. Case effectively under review.	-
In addition to the 50 cases examined by S&ME, 13 cases were referred to High Wealth Individuals for consideration and were determined to warrant no further action.	In addition to the 45 cases examined by S&ME, 3 were referred to High Wealth Individuals for consideration and were determined to warrant no further action.

Source: Tax Office.

5.43 From these exercises S&ME concluded that:

- (a) several taxpayers were unaware that taxes had been withheld overseas and that they might be able to claim a foreign tax credit, with the net result being a reduction in tax liability;
- (b) tax agents and taxpayers require more education regarding the requirements of reporting overseas income; and
- (c) consideration of improvements to taxpayer information materials regarding overseas income may be warranted.

High Wealth Individuals (HWI)

5.44 The High Wealth Individuals market segment is responsible for closely monitoring a small portfolio of high wealth taxpayers. High wealth individuals pay higher amounts of tax, and there is therefore greater financial incentive for them to engage in tax avoidance behaviour. Further, high wealth individuals have the financial resources and access to expert advice to facilitate the minimisation of tax in ways which may not be available to other less well resourced taxpayers. At the time the ANAO undertook fieldwork for this audit a structured compliance exercise using AEOI data had not occurred in HWI.

5.45 However, given the concentration of the HWI market, the Tax Office is more likely to use Specific information exchange requests under DTA arrangements to collect information as a pre-cursor to compliance activities.

Summary of AEOI compliance activities

5.46 The Tax Office obtains limited measurable benefits from using AEOI data. AEOI data is used mainly in conjunction with other data sources as part of the Tax Office's ongoing and overall compliance activities. This mainly results from the impediments to the effective use of AEOI outlined in paragraph 2.9. These factors collectively reduce the benefits of utilising AEOI data.

5.47 There are limited instances of year-on-year replication of exercises within business line areas using AEOI data. However, the Tax Office has indicated it continues to explore how best to fully leverage the AEOI resource and increase its effective and efficient use within the context of its overall broader compliance program to address identified risks.

5.48 After ANAO audit fieldwork had concluded the Tax Office advised that the International Relations Section would manually examine AEOI data to identify cases with the potential to generate significant revenue gain and refer those cases to individual compliance areas for further consideration.

Compliance activity coordination

5.49 Notwithstanding the limited success in utilising AEOI information as a data source to inform compliance exercises to date, there are opportunities for improving the outcomes resulting from compliance exercises using AEOI data through greater co-ordination and analysis. Initiatives which may prove beneficial include:

- (a) using the Exchange of Information Advisory Committee as a focal point to capture and disseminate advances in AEOI compliance exercise methodology which occur when Tax Office compliance areas use AEOI data;
- (b) facilitating improvements in compliance coordination by adopting a purposeful approach to compliance exercises which choose to use AEOI data, by requiring methodologies to be submitted to the Exchange of Information Advisory Committee for consideration and review;

- (c) providing evaluations of compliance exercises which utilise AEOI data to the Exchange of Information Advisory Committee; and
- (d) assisting compliance areas to leverage AEOI data through a periodic review of the AEOI data resource to provide information to the Exchange of Information Advisory Committee, and the users of the AEOI data through an intranet solution, to better inform future decision making and resource allocation when considering the use of AEOI data to address taxpayer behaviour risk.

Recommendation No.2

5.50 The ANAO recommends that, in developing compliance strategies to address identified compliance risks, the Tax Office have regard, when appropriate, to the learnings gained from previous compliance activities utilising AEOI data.

5.51 Tax Office Response: Agreed. *The ATO, along with other tax administrations, is continuing to improve its use of AEOI data. We are developing strategies to use AEOI data more effectively, in conjunction with other data sources to identify and address compliance risks. When established, the central information area will assist in analysing and sharing the learnings gained from previous compliance activities.*

Identity matching

5.52 The Tax Office undertakes two major types of identity matching as part of its compliance program:

- large scale post-issue semi-automated system processing which automatically matches data from third party sources, against data disclosed in tax returns lodged by taxpayers, detects discrepancies and produces a pool of discrepant cases for compliance activity; and
- identity matching projects e.g. business lines initiate projects that involve acquiring and matching external data to internal Tax Office databases and producing a pool of cases for risk identification or compliance activity.

5.53 Identity matching processes enable the Tax Office to match descriptive taxpayer information (e.g. name, address, date of birth⁷⁵) contained in AEOI records against the Tax File Number (TFN) client register, as a precursor to computer assisted compliance activities. The outcome of an identity matching exercise is the appending of an Australian TFN and confidence indicator to the AEOI record to facilitate further use, including for compliance exercise purposes.

5.54 Not all data which undergoes identity matching by the Tax Office is able to be matched with sufficient confidence to permit further use in computer assisted compliance exercises. The Tax Office advised:

“Outcomes at higher levels of confidence are generally deemed suitable for fully automated compliance and audit work. Outcomes at medium and low confidence levels can be used in manual processes and also form the basis of engine development and data quality initiatives.”⁷⁶

5.55 The Tax Office does not conduct automated compliance exercises which use AEOI data categorised at the unmatched, low or medium identity matching levels. The identity matching software used by the Tax Office has not been significantly upgraded since 2003.

5.56 Because the identity matching software has not significantly altered, the improving trend in achieved identity matching confidence level is likely to be significantly influenced by improvements in the quality of the incoming data provided by DTA partners.⁷⁷ To a lesser extent familiarity with AEOI data and improved pre-matching data manipulation has also assisted identity matching outcomes. The confidence levels applied to the data through identity matching routines have increased over time, see Figure 5.1, below.

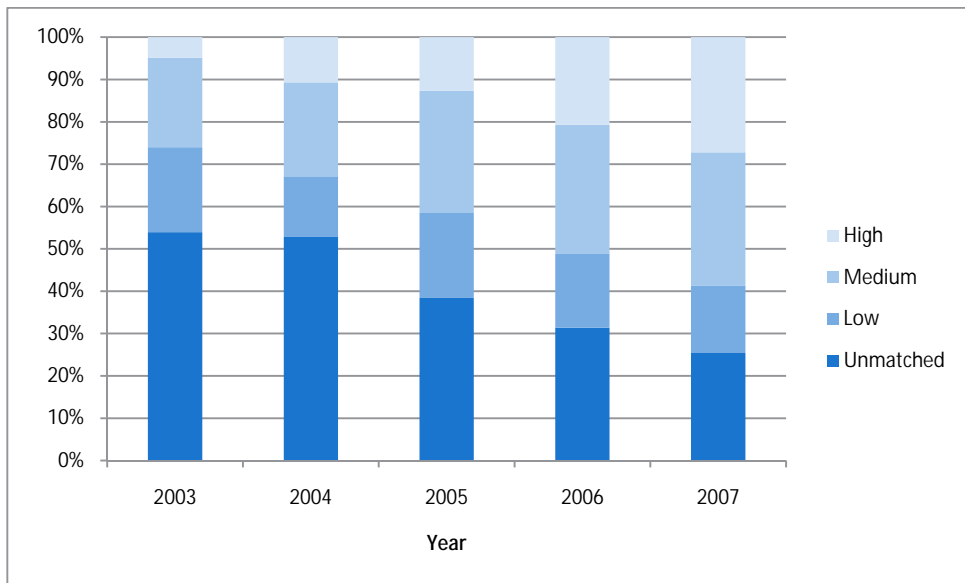
⁷⁵ The Tax Office uses a large number of information fields for identity matching, in addition to those items listed.

⁷⁶ Tax Office (2007), internal publication “An Executive Overview of ATO Identity Matching Software”

⁷⁷ There are two elements to “data quality”. The first element, which Figure 5.1 reflects, is the extent to which data can be identity matched to allow integration into the existing knowledge base. Quality in this context can be derived programmatically. The second element is whether the information contained in the AEOI record is useful when it is utilised. This second context may not become apparent until the Tax Office actually uses the data in compliance exercises.

Figure 5.1

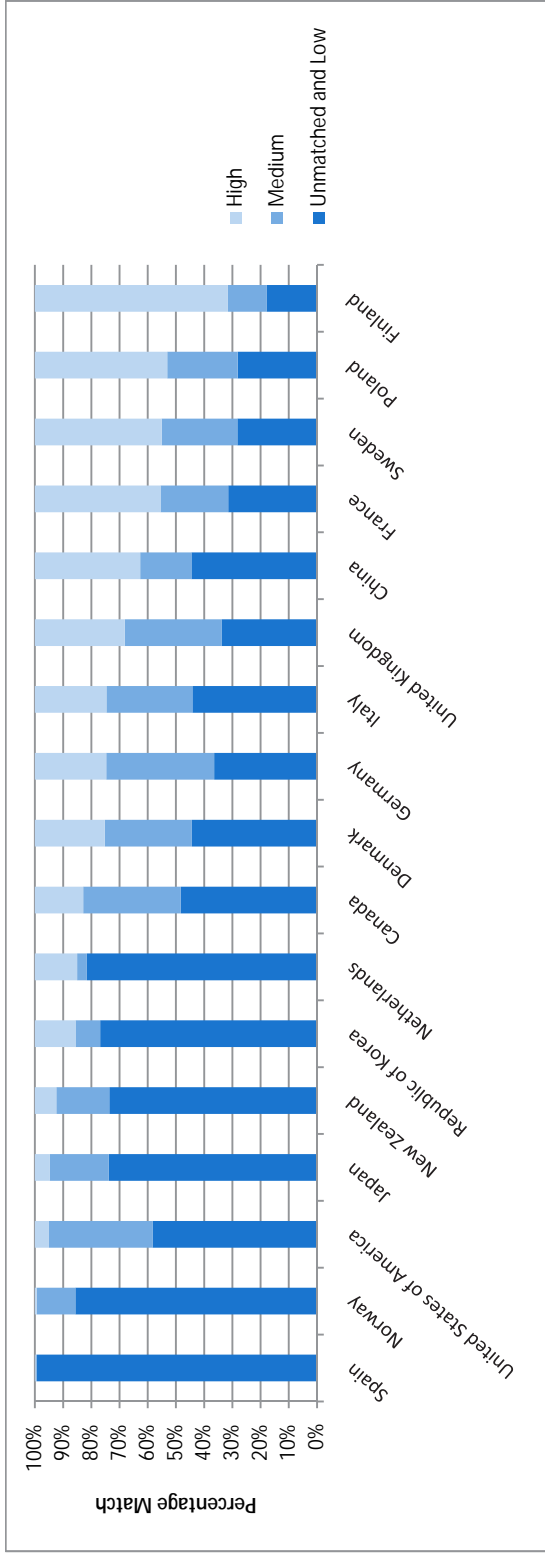
Identity matching of AEOI records over time



Source: ANAO analysis of Tax Office data.

5.57 However, whilst Figure 5.1 illustrates an improving situation over time, aggregation of the data serves to mask significant individual jurisdiction variability. The Tax Office advised that the quality and completeness of the data reported by DTA partners was the major contributing factor to the variances noted in Figure 5.2 below.

Figure 5.2
Identity matching confidence achieved by the Tax Office for received AEOL data, for financial period, 2003–2007



Source: ANAO analysis of Tax Office data.

Note: Only DTA partners with available data are depicted.

5.58 The properties of the available AEOI data change over time. AEOI data may be provided to the Tax Office inconsistently, in batches, or may be significantly in arrears as DTA partners develop new capabilities and seek to provide “catch up” sets. As a consequence, the properties of the total available pool of AEOI data available for use in compliance exercises is variable which in turn influences the utility which the Tax Office may derive.

5.59 Additionally, each individual DTA partner which supplies AEOI data has variances at the data element level through time.⁷⁸ For example, within a given jurisdictional system, legislative support and administrative capability tends to improve through time. As a consequence, different elements of AEOI data, for example, capital gains, or wages income, may, at a data element level be more useful when considered against the average usefulness of all data provided by that jurisdiction.

5.60 The design of compliance exercises would be assisted if the Tax Office developed a deeper understanding of the properties of the AEOI data. An accepted view on the properties of AEOI data would be of considerable assistance to compliance managers when they are considering the capability of AEOI data to address identified compliance risks.



Ian McPhee
Auditor-General

Canberra ACT
18 May 2010

⁷⁸ For example, there are data elements which relate to different forms of foreign source income and capital gains.

Appendices

Appendix 1: Tax Office Response



Australian Government
Australian Taxation Office

SECOND COMMISSIONER OF TAXATION

Mr David Crossley
Executive Director
Performance Audit Services Group



Dear Mr Crossley,

ANAO Performance Audit:

The Tax Office's management and use of Double Taxation Agreement information collected through automatic exchange

Thank you for your letter of 12 March 2010, submitting the proposed audit report on *The Tax Office's management and use of Double Taxation Agreement information collected through automatic exchange* for our comments and response.

Summary of comments

The ATO welcomes the Australian National Audit Office's (ANAO) recommendations in relation to its management and use of Double Taxation Agreement information collected through automatic exchange.

Automatic Exchange of Information (AEOI) contributes to the transparency of taxpayer's international economic activity. Increased transparency provides an opportunity to ensure that taxpayers are appropriately declaring income derived overseas. AEOI contributes to compliance activities conducted by the Tax Office. In particular I note your finding that:

Over the past five years, the Tax Office has increased its use of AEOI data. Efficient use of AEOI data in compliance exercises is supported by an identity matching capability which provides a means to match AEOI data to the Tax Office's Tax File Number client register, at an assigned level of confidence

This should provide reassurance to the community that it can have confidence in this important aspect of our tax administration.

As noted in the report, the Tax Office has a long history of developing the operational capabilities and international linkages with Double Tax Agreement (DTA) partners essential for establishing and expanding the AEOI program. In addition the report acknowledges notwithstanding the challenges and limitations involved in the international transfer of large amounts of taxpayer information, the Tax Office's management of the AEOI program has generally been sound. Further, the Tax Office continues to work with Australia's treaty partners to encourage ongoing improvement in the quantity and quality of AEOI transfers.

Your audit has confirmed that we are on the right track with the improvements that we have underway or planned.

The ATO accepts the two recommendations and provides the following comments.

Recommendation No.1

Para 2.24

The ANAO recommends that, to facilitate effective compliance strategy development, the Tax Office consolidate its DTA information exchange knowledge into a centralised information repository.

Agreed

Comment: The ATO is in the process of establishing a central information area on our intranet to capture and share intelligence at a strategic level on our work relating to AEOI cases. This information will be made available to ATO staff to support the use of automatic EOI data for compliance purposes. This will include sharing methodologies and outcomes to facilitate more effective approaches to use of the automatic EOI data. The EOI Advisory Committee will oversight the implementation of this initiative.

Recommendation No.2

Para 5.50

The ANAO recommends that, in developing compliance strategies to address identified compliance risks, the Tax Office have regard, when appropriate, to the learnings gained from previous compliance activities utilising AEOI data.

Agreed

Comment: The ATO, along with other tax administrations, is continuing to improve its use of AEOI data. We are developing strategies to use AEOI data more effectively, in conjunction with other data sources to identify and address compliance risks. When established, the central information area will assist in analysing and sharing the learnings gained from previous compliance activities.

If there are any questions concerning our response, please contact Ms Cheryl - Lea Field on 6216 2376.

Yours sincerely



Bruce Quigley
Second Commissioner of Taxation

4 April 2010

Appendix 2: OECD assessment reports

The tables that follow report the significant international activity which has occurred in the drive for greater tax administration transparency. These two reports are from April 2009 and January 2010; over a short period there has been significant improvement as reflected in the degree of change between these two reports. For example, the countries which have been considered to have “substantially implemented the internationally agreed tax standard⁷⁹” increased from 40 jurisdictions in April 2009 to 63 jurisdictions by January 2010.

The internationally agreed tax standard encourages transparency through the exchange of information between jurisdiction, consistent with the objective use of AEOI in this report. The snapshots provided in the reports provide an indication of the importance of initiatives such as AEOI which support domestic compliance activities, and, can also be considered to contribute to facilitating internationally transparent financial dealings and the integrity of international taxation collection.

⁷⁹ See Note 1, later in this appendix, which explains the context of the internationally agreed tax standard.

Table A2-1

OECD progress report on implementation of the internationally agreed tax standard (2 April 2009).

Jurisdictions that have substantially implemented the internationally agreed tax standard			
Argentina	Germany	Korea	Seychelles
Australia	Greece	Malta	Slovak Republic
Barbados	Guernsey	Mauritius	South Africa
Canada	Hungary	Mexico	Spain
China ²	Iceland	Netherlands	Sweden
Cyprus	Ireland	New Zealand	Turkey
Czech Republic	Isle of Man	Norway	United Arab Emirates
Denmark	Italy	Poland	United Kingdom
Finland	Japan	Portugal	United States
France	Jersey	Russian Federation	US Virgin Islands

Jurisdictions that have committed to the internationally agreed tax standard, but have not yet substantially implemented					
Jurisdiction	Year of Commitment	Number of Agreements	Jurisdiction	Year of Commitment	Number of Agreements
Tax Havens³					
Andorra	2009	(0)	Marshall Islands	2007	(1)
Anguilla	2002	(0)	Monaco	2009	(1)
Antigua and Barbuda	2002	(7)	Montserrat	2002	(0)
Aruba	2002	(4)	Nauru	2003	(0)
Bahamas	2002	(1)	Netherlands Antilles	2000	(7)
Bahrain	2001	(6)	Niue	2002	(0)
Belize	2002	(0)	Panama	2002	(0)
Bermuda	2000	(3)	St Kitts and Nevis	2002	(0)
British Virgin Islands	2002	(3)	St Lucia	2002	(0)
Cayman Islands ⁴	2000	(8)	St Vincent & Grenadines	2002	(0)
Cook Islands	2002	(0)	Samoa	2002	(0)
Dominica	2002	(1)	San Marino	2000	(0)
Gibraltar	2002	(1)	Turks and Caicos Islands	2002	(0)
Grenada	2002	(1)	Vanuatu	2003	(0)
Liberia	2007	(0)			
Liechtenstein	2009	(1)			
Other Financial Centres					
Austria ⁵	2009	(0)	Guatemala	2009	(0)
Belgium ⁵	2009	(1)	Luxembourg ⁵	2009	(0)
Brunei	2009	(5)	Singapore	2009	(0)
Chile	2009	(0)	Switzerland ⁵	2009	(0)

Jurisdictions that have not committed to the internationally agreed tax standard			
Jurisdiction	Number of Agreements	Jurisdiction	Number of Agreements
Costa Rica	(0)	Philippines	(0)
Malaysia (Labuan)	(0)	Uruguay	(0)

Source: <www.oecd.org>.

Notes - OECD progress report on implementation of the internationally agreed tax standard (April 2009).

1. The internationally agreed tax standard, which was developed by the OECD in co-operation with non-OECD countries and which was endorsed by G20 Finance Ministers at their Berlin Meeting in 2004 and by the UN Committee of Experts on International Cooperation in Tax Matters at its October 2008 Meeting, requires exchange of information on request in all tax matters for the administration and enforcement of domestic tax law without regard to a domestic tax interest requirement or bank secrecy for tax purposes. It also provides for extensive safeguards to protect the confidentiality of the information exchanged.
2. Excluding the Special Administrative Regions, which have committed to implement the internationally agreed tax standard.
3. These jurisdictions were identified in 2000 as meeting the tax haven criteria as described in the 1998 OECD report.
4. The Cayman Islands has enacted legislation that allows them to exchange information unilaterally and has identified 12 countries with which it is prepared to do so. This legislation is being reviewed by the OECD.
5. Austria, Belgium, Luxembourg and Switzerland withdrew their reservations to Article 26 of the OECD Model Tax Convention. Belgium has already written to 48 countries to propose the conclusion of protocols to update Article 26 of their existing treaties. Austria, Luxembourg and Switzerland announced that they have started to write to their treaty partners to indicate that they are now willing to enter into renegotiations of their treaties to include the new Article 26.

Source: <www.oecd.org>.

Table A2-2

OECD progress report on implementation of the internationally agreed tax standard (20 January 2010).

Jurisdictions that have substantially implemented the internationally agreed tax standard			
Antigua and Barbuda	Denmark	Jersey	San Marino
Argentina	Estonia	Korea	Seychelles
Aruba	Finland	Liechtenstein	Singapore
Australia	France	Luxembourg	Slovak Republic
Austria	Germany	Malta	Slovenia
Bahrain	Gibraltar	Mauritius	South Africa
Barbados	Greece	Mexico	Spain
Belgium	Guernsey	Monaco	Sweden
Bermuda	Hungary	Netherlands	Switzerland
British Virgin Islands	Iceland	Netherlands Antilles	Turkey
Canada	India	New Zealand	Turks and Caicos Islands
Cayman Islands ²	Ireland	Norway	United Arab Emirates
Chile	Isle of Man	Poland	United Kingdom
China ³	Israel	Portugal	United States
Cyprus	Italy	Russian Federation	US Virgin Islands
Czech Republic	Japan	Samoa	

Jurisdictions that have committed to the internationally agreed tax standard, but have not yet substantially implemented					
Jurisdiction	Year of Commitment	Number of Agreements	Jurisdiction	Year of Commitment	Number of Agreements
Tax Havens⁴					
Andorra	2009	(10)	Nauru	2003	(0)
Anguilla	2002	(11)	Niue	2002	(0)
Bahamas	2002	(10)	Panama	2002	(0)
Belize	2002	(1)	St Kitts and Nevis	2002	(9)
Cook Islands	2002	(11)	St Lucia	2002	(5)
Dominica	2002	(1)	St Vincent and the Grenadines	2002	(8)
Grenada	2002	(1)	Vanuatu	2003	(1)
Liberia	2007	(0)			
Marshall Islands	2007	(1)			
Montserrat	2002	(2)			
Other Financial Centres					
Brunei	2009	(8)	Malaysia	2009	(8)
Costa Rica	2009	(1)	Philippines	2009	(0)
Guatemala	2009	(0)	Uruguay	2009	(3)

Jurisdictions that have not committed to the internationally agreed tax standard			
Jurisdiction	Number of Agreements	Jurisdiction	Number of Agreements
All jurisdictions surveyed by the Global Forum have now committed to the internationally agreed tax standard			

Source: <www.oecd.org>.

Notes - OECD progress report on implementation of the internationally agreed tax standard (20 January 2010).

1. The internationally agreed tax standard, which was developed by the OECD in co-operation with non-OECD countries and which was endorsed by G20 Finance Ministers at their Berlin Meeting in 2004 and by the UN Committee of Experts on International Cooperation in Tax Matters at its October 2008 Meeting, requires exchange of information on request in all tax matters for the administration and enforcement of domestic tax law without regard to a domestic tax interest requirement or bank secrecy for tax purposes. It also provides for extensive safeguards to protect the confidentiality of the information exchanged.
2. The Cayman Islands have enacted legislation that allows them to exchange information unilaterally and have identified 12 countries with which they are prepared to do so. This approach is being reviewed by the OECD.
3. Excluding the Special Administrative Regions, which have committed to implement the internationally agreed tax standard.
4. These jurisdictions were identified in 2000 as meeting the tax haven criteria as described in the 1998 OECD report.

Source: <www.oecd.org>.

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