

The Auditor-General
ANAO Report No.5 2014–15
Performance Audit

Annual Compliance Arrangements with Large Corporate Taxpayers

Australian Taxation Office

© Commonwealth of Australia 2014

ISSN 1036–7632 (Print)

ISSN 2203–0352 (Online)

ISBN 0 642 81514 3 (Print)

ISBN 0 642 81515 1 (Online)

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Canberra ACT
6 November 2014

Dear Mr President
Dear Madam Speaker

The Australian National Audit Office has undertaken an independent performance audit in the Australian Taxation Office titled *Annual Compliance Arrangements with Large Corporate Taxpayers*. The audit was conducted 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 to the Parliament.

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

Yours sincerely



Ian McPhee
Auditor-General

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

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Abbreviations

ACA	Annual Compliance Arrangement
ANAO	Australian National Audit Office
APA	Advance Pricing Agreement
ATO	Australian Taxation Office
BSL	Business and Service Line
CAP	Compliance Assurance Process
CIW	Community Involvement Workshop
ECAP	External Compliance Assurance Process
FBT	Fringe Benefits Tax
FCA	Forward Compliance Arrangement
FTE	Full Time Equivalent
GAO	United States Government Accountability Office
GST	Goods and Services Tax
IGoT	Inspector-General of Taxation
IRS	United States Internal Revenue Service
ITX	Indirect Tax
KTR	Key Taxpayer Review
LB&I	Large Business and International
MAP	Mutual Agreement Procedure
MoU	Memorandum of Understanding

OECD	Organisation for Economic Co-operation and Development
PCR	Pre-lodgment Compliance Review
PGH	Public Groups and High Wealth Individuals
PG&I	Public Groups and International
PRRT	Petroleum Resource Rent Tax
RDF	Risk Differentiation Framework
RTP	Reportable Tax Position Schedule
ToA	Terms of Arrangement

Summary and Recommendations

Summary

Introduction

1. The Australian Taxation Office (ATO) is responsible for administering Australia's taxation and superannuation systems. It seeks to build confidence in its administration by helping people understand their rights and obligations, improving ease of compliance and access to benefits, and managing non-compliance with the law. The ATO's administration covers a broad range of taxpayers, including individuals, small businesses and large corporate taxpayers.¹
2. Of the \$311.5 billion in net tax collected in 2012–13, the ATO advised that large corporate taxpayers contributed around \$155.5 billion (49.9 per cent).² In this light, the tax behaviour of these entities is integral to the health of Australia's tax system, with potential consequences for the total revenue collected should they fail to meet their tax obligations.
3. The ATO's compliance model provides the framework for assessing the risks of taxpayer non-compliance and developing responses according to the nature and level of identified risk, the causes of non-compliance and the level of cooperation of the taxpayers. For large corporate taxpayers, the ATO also aims to differentiate its compliance approach and level of engagement according to categories of risk—higher risk, key taxpayers, medium risk and lower risk assessed through its Risk Differentiation Framework.³ Particular focus is given to the larger entities within this group as they present a higher risk to overall taxation revenue through non-compliance.⁴

-
- 1 Most large corporate taxpayers are companies but others are government departments, partnerships, trusts, non-profit organisations and superannuation funds, all with annual turnover greater than \$250 million.
 - 2 Large corporate taxpayers' contributions include pay as you go taxes withheld by the employer on behalf of their employees.
 - 3 The Risk Differentiation Framework is a modelling tool that provides a relative risk profile of a population of taxpayers. Through the framework, the ATO estimates the likelihood and consequence of non-compliance with tax obligations to establish an overall risk categorisation for each taxpayer, which provides the basis for determining compliance treatments.
 - 4 In 2013–14, of the 1100 entities in the ATO's 'large market', 158 were categorised as 'key taxpayers' as they were assessed as having a low likelihood of not meeting their tax obligations, but the amount of their tax liability means that any incorrect payment could have serious consequences for overall tax revenue. A further two taxpayers were categorised as higher risk, as they were assessed as having both a high likelihood and consequence of non-compliance.

4. While continuing its program of retrospective risk reviews, audits and other compliance activities⁵, the ATO has increased efforts in recent years to build cooperative relationships with large corporate taxpayers, particularly those rated as 'key'. These relationships aim to support full and open disclosure of contestable tax positions, and the identification and mitigation of tax risks in 'real time'. This approach reflects the ATO view that most large corporate taxpayers are willing to comply, but that ongoing monitoring will assist it to clarify contestable positions in real time. It also aligns with the ATO's 2020 vision.⁶

5. To support cooperative relationships, the ATO has developed a number of compliance initiatives that aim to build enhanced positive relationships and compliance outcomes with large corporate taxpayers. The ATO considers Annual Compliance Arrangements (ACAs) to be the centrepiece of these efforts.⁷ ACAs are directed at key large corporate taxpayers, and offer potential benefits, such as greater practical certainty about their tax positions, concessional treatment for penalties and interest, and higher levels of accessibility to the ATO. In return, these taxpayers are required to have good governance arrangements and disclose tax risks in real time. In this way, ACAs, which are voluntary, are intended to offer a 'no surprises' approach, with potential benefits for both the ATO and the taxpayer.

6. Cooperative compliance approaches have been adopted by many countries. In July 2013, the Organisation for Economic Co-operation and Development (OECD) reported on its assessment of 24 countries, including Australia, and noted the collaborative relationships being developed between large corporate taxpayers and revenue agencies.⁸ The OECD considers that cooperative compliance arrangements can assist revenue agencies to improve compliance by large corporate taxpayers. In this regard, it highlights the importance of transparency, disclosure and good governance systems on the part of both parties to reduce uncertainties over entities' tax positions. The

5 The ATO scans the tax returns of all large corporate taxpayers through a variety of risk filters, and conducts formal risk reviews of around 30 per cent of these taxpayers, with 18 per cent of this group subject to an audit. ATO, *Large business and tax compliance*, p. 4.

6 The ATO's 2020 vision refers to the strategies and principles underpinning the ATO's administration of the tax and superannuation systems in moving towards the year 2020 and a lighter or no touch experience for taxpayers.

7 Speech by the then Commissioner of Taxation: 'A new dimension', delivered at the Corporate Tax Association Convention, Sydney, 12 May 2008.

8 OECD, *Co-operative Compliance: A Framework: From Enhanced Relationship to Co-operative Compliance*, 2013, p. 87.

OECD also considers that cooperative compliance can help to restore trust and confidence in the relationship between business and tax administrations.⁹ While recognising concerns about the compatibility of this approach with equality before the law, the OECD concluded that cooperative compliance is entirely consistent with modern compliance risk management principles.

Administration of ACAs

7. ACAs were introduced by the ATO in 2008, and as at July 2014, there were 24 ACAs in place. Of these: 18 were with large companies, five with state government departments, and one with an Australian government entity.

8. Over time, the ATO has revised the basis for selecting taxpayers to enter into an ACA. Initially these arrangements were to be limited to the 50 largest entities, based solely on turnover. Now, as previously noted, only large entities assessed as 'key taxpayers' are considered potentially suitable for an ACA. The ATO informs large corporate taxpayers of its overall assessment of their relative risk of non-compliance, including if they are rated as potentially suitable for an ACA. It is open to these taxpayers to initiate discussions with the ATO to enter an ACA.

9. Taxpayers can negotiate an ACA for a single tax or for any combination of up to five separate taxes.¹⁰ As at June 2014, 13 ACAs were in place for a single tax and 11 were for two or more taxes. Most ACAs relate to goods and services tax (17 arrangements), with 12 for income tax, eight for fringe benefits tax, two for excise, and one for petroleum resource rent tax.

10. As ACAs cover different taxes, the ATO administers them through its various business and service lines in the Compliance Group. High-level oversight is provided through the ACA Oversight Committee, which includes senior executive staff from the business and service lines administering ACAs, reporting directly to the respective Deputy Commissioners in the Compliance Group.

9 In recent years, there has also been considerable criticism of these relationships, and the capacity of tax administrations to address the aggressive tax practices of some multinational companies that shift profits between jurisdictions to minimise tax liabilities. *ibid.*, pp. 11–14.

10 Taxpayers will choose to enter into ACAs for particular taxes for various business reasons. For example, many taxpayers enter into ACAs for GST and excise to access concessional treatment for penalties and interest and to receive extended correcting thresholds (relating to value and time) for errors. Taxpayers may enter into ACAs for income tax to increase the level of certainty of their tax positions.

11. The ATO has adopted the following three-phase process for entering into and administering ACAs:

- entry into the ACA—where the taxpayer’s governance arrangements are confirmed and a terms of arrangement document developed that sets out how the ACA will work;
- administration throughout the year—where the taxpayer continuously discloses material tax risks and the ATO reviews these disclosures; and
- closure at the end of the financial year—where the ATO and the taxpayer jointly review the taxpayer’s tax return. The ATO provides sign-off for low risk tax issues and develops mitigation strategies to address higher risk issues. The renewal of the ACA is also covered during this stage.

12. If the taxpayer voluntarily enters into an ACA, the ATO has agreed not to apply alternative compliance approaches, such as:

- pre-lodgment compliance reviews—used to identify and assess large corporate taxpayers’ income tax risks in the pre and post-lodgment periods;
- reportable tax position schedules—many large corporate taxpayers are required to disclose their more contestable and material income tax positions; and
- key taxpayer reviews—piloted in 2013–14 for the goods and services tax (GST) and excise, and implementation will be considered during the development of the 2014–15 Compliance Plan.

Reviews of ACAs

13. In the last two years, ACAs have been the subject of a review by the Inspector-General of Taxation¹¹ and four ATO internal reviews¹². The most recent internal review, at draft report stage in September 2014, considered the findings and recommendations of the previous reviews, which had highlighted scope to improve technical and strategic aspects of ACAs, particularly those

11 Inspector General of Taxation, *Review into Improving the Self-Assessment System*, August 2012.

12 The internal reviews included the: Review of Annual Compliance Arrangements (based on the views of ATO officers managing income tax ACAs), November 2012; PG&I ACA Community Involvement Workshop, February 2014; Annual Compliance Arrangements Strategy Review (GST), April 2014; and *Annual Compliance Arrangements (ACA) Review*, draft, September 2014.

covering income tax and goods and services tax (GST). The draft report noted ‘several operational and strategic concerns with the way ACAs are being applied as a real-time compliance product’, particularly their relatively high cost in the start-up years.¹³

Audit objective and criteria

14. The objective of the audit was to assess the effectiveness of the Australian Taxation Office’s administration of annual compliance arrangements with large corporate taxpayers.

15. To form a conclusion against this objective, the ANAO adopted the following high-level criteria:

- the governance arrangements for ACAs are well planned and effective;
- there are sound processes for identifying entities to enter into an ACA;
- results achieved to date reflect initial expectations of ACAs; and
- individual ACAs are effectively administered, in accordance with internal policies and procedures, to achieve intended benefits.

Overall conclusion

16. ACAs were introduced in 2008 in response to feedback from large corporate taxpayers that they were looking for a ‘no surprises’ approach in relation to their tax positions. Built on the premise that taxpayers would have sound tax governance arrangements and provide full and true disclosure, ACAs aim to provide taxpayers with greater practical certainty of their tax positions. The ATO sees ACAs as the premium cooperative compliance arrangement for large corporate taxpayers. As such, they are closely aligned with the ATO’s 2020 vision, which embraces real-time engagement and disclosure as well as a lighter touch for compliant taxpayers.

17. The effective administration of ACAs relies on judgements by the ATO as to the soundness of the governance arrangements put in place by large corporate taxpayers, the reliability of the information they disclose on significant matters affecting their taxation liability, and the review of this information by the ATO on an annual basis. While not without risks to both

13 ATO, *Annual Compliance Arrangements (ACA) Review*, draft, September 2014, p. 7.

parties, this approach is consistent with contemporary international practice of building cooperative relationships with those larger corporate taxpayers considered willing to meet their tax obligations and unlikely to be involved in aggressive tax planning practices. ACAs have also delivered benefits to participating taxpayers. These taxpayers advised the ANAO that the arrangements have provided greater certainty for more straightforward taxation matters and improved the ATO's responsiveness to their concerns.¹⁴

18. Notwithstanding the positive experiences of participating taxpayers, take-up of ACAs has been low. In 2013–14 only 24 of the 158 potentially suitable key taxpayers (15 per cent) had an ACA, and six of these taxpayers would not be categorised as 'key' under the current risk assessment arrangements.¹⁵ As such, ACAs have not been the centrepiece of cooperative collaboration with large corporate taxpayers as envisaged when introduced, but do provide an alternative approach for large corporate taxpayers to engage with the ATO on potentially contentious tax matters. Most large corporate taxpayers are aware of ACAs as a result of the ATO's promotional efforts but prefer to be subject to alternate compliance activities, such as pre-lodgment compliance reviews, instead of voluntarily entering into an ACA.¹⁶

19. Taxpayers have advised the ANAO and the ATO that the main reason for not entering into an ACA was the relatively high cost of meeting the requirements of the ACA, particularly at the entry phase. They perceived other compliance activities to have similar benefits but lower administrative demands.¹⁷ Although the ATO has not quantified the cost of participating in or administering an ACA, it recognises these concerns, and is looking to better tailor the intensity of its compliance activity to the assessed risk, as envisaged in its 2020 vision.¹⁸

14 These views were elicited in interviews the ANAO conducted with the 25 taxpayers that had an existing ACA or had previously held an ACA.

15 These six taxpayers entered into ACAs prior to the introduction of the current risk assessment arrangements, and would now not be rated key because they are not sufficiently large in terms of the likely consequences of non-compliance.

16 By entering into an ACA, taxpayers can ensure they are precluded from certain other compliance activities, such as pre-lodgment compliance reviews for income tax and key taxpayer reviews for GST.

17 The ANAO surveyed 12 taxpayers potentially suitable for an ACA but had not entered into an arrangement. Similarly, the ATO surveyed 14 potentially suitable taxpayers without an ACA as part of its 2014 ACA Review.

18 Under the 2020 vision, taxpayers that demonstrate openness, transparency and willingness to participate in the tax system would have a 'lighter touch' experience than those that do not.

20. ACAs currently provide a differentiated means by which the ATO can engage with large corporate taxpayers. If ACAs are to be positioned to maximise the participation of suitable large corporate taxpayers, it will be important for the ATO to reassess the extent of differentiation, taking into account the costs and benefits to taxpayers and itself. In this regard, the ATO will also have to decide whether ACAs are to be positioned more as part of the spectrum of compliance approaches going forward rather than as the centrepiece of cooperative collaboration as initially envisaged.

21. In administering existing ACAs, shortcomings in recordkeeping and oversight have meant that the ATO could not readily demonstrate: the extent and outcomes of its efforts to gain assurance over taxpayers' governance arrangements; the number, nature and treatment of disclosures; or success in encouraging higher levels of compliance on the part of those large corporate taxpayers with an ACA. Accordingly, the ATO has not administered ACAs as effectively as it could have, particularly when these arrangements were viewed as a flagship measure that provided a new and innovative way of engaging with large corporate taxpayers.

22. Issues surrounding the design and administration of ACAs have been raised in recent internal and external reviews, in line with the findings of this audit. It is apparent the ATO needs to act on these findings to improve the effectiveness of ACAs if they are to achieve the benefits envisaged when the arrangements were introduced in 2008.

23. Further, the ANAO has made two recommendations aimed at improving the design of ACAs, and the ATO's recording of taxpayers' disclosures of contentious tax positions and how they were dealt with through ACA processes.

Key findings by chapter

Management Arrangements (Chapter 2)

24. The ATO has created a matrix structure to manage tax compliance, based on the type of tax and the market segment. Consequently, ACAs are administered across different business and service lines, drawing on the knowledge and expertise of the staff in these areas. This approach supports the administration of individual ACAs, but has generated inconsistency in the

negotiation, operation and sign-off of the arrangements.¹⁹ While the ATO has taken some steps to improve the administration of ACAs, such as the establishment of the ACA Oversight Committee in June 2012²⁰, a lack of coordination, intelligence and information exchange across business and service lines was apparent. There has also been considerable slippage in the Committee progressing key elements of its work program, including refining policies, reviewing processes and developing supporting procedures for administering ACAs. These shortcomings belie ACAs being administered as the ATO's premium cooperative compliance arrangement.

25. The level of internal and external reporting is proportionate to the scale of ACA activity. However, the ATO has been slow to evaluate the approach to determine if it is achieving the benefits envisaged. The first effectiveness evaluation report is due to be completed late in 2014, although this evaluation project has been ongoing for almost two years. Interim findings from this evaluation, and previous ATO reviews indicate that ACAs have improved relationships with large corporate taxpayers and, in doing so, have potentially supported compliant behaviour. While the interim findings drew on the views of taxpayers and ATO officers about the costs of ACAs, it has not quantified the costs of administering ACAs, the benefits or the impacts on revenue.

Positioning of ACAs within the ATO's Compliance Framework (Chapter 3)

26. ACAs are intended to be at the centre of the ATO's efforts to develop cooperative compliance relationships with large corporate taxpayers. The ATO initially offered ACAs to the top 50 corporate taxpayers by turnover, and extended this to the top 100 taxpayers when take up numbers were low. In 2011–12, following the introduction of the Risk Differentiation Framework as the ATO's risk modelling tool, the ATO wrote to 35 of the 133 large corporate taxpayers then rated as 'key', specifically inviting them to enter into an ACA.

27. The ATO has also promoted ACAs publicly through: various industry groups; ATO contacts; community and stakeholder forums; and regular ATO publications. Despite these efforts, only 24 of the 158 potentially suitable key

19 ATO, *Annual Compliance Arrangement Review*, draft, September 2014.

20 In addition, ACAs have a steering committee with ultimate responsibility for the ACA and a working group for each tax to provide support to the steering committee.

taxpayers (15 per cent) had entered into an ACA by July 2014.²¹ The low level of participation has been raised in a number of recent reviews, and the ATO is consequently considering options for improving take-up. Of prime importance is the need to clarify the purpose of ACAs²² and to develop a strategy for positioning these arrangements within the compliance framework for large corporate taxpayers.

28. There is scope for the ATO to better differentiate the operation and administrative requirements of ACAs from other compliance activities, and better align the benefits and costs across the range of compliance activities for large corporate taxpayers. In this way, the requirements for administering and participating in an ACA would be proportional to the level of risk associated with the specific taxpayer and support the effective use of resources by the ATO and taxpayers.

29. Developing a comprehensive compliance strategy for large corporate taxpayers that clearly distinguishes ACAs from other compliance activities would enable the ATO to more actively market ACAs.

Administration of ACAs (Chapter 4)

30. An ACA is the basis for the relationship between the ATO and the ACA holder. As such, the activities undertaken and the terms of the ACA are intended to be flexible and able to be tailored to the individual circumstances of the ACA holder and the complexity of the tax issues. Nonetheless, there is a need for the ATO to closely monitor differences across ACAs, especially in the terms established during the negotiation phase. The ANAO's review of all 24 ACAs in place as at July 2014 identified variability across ACAs and that the reasons for this variability were not always clear. Although the ACA Oversight Committee now reviews the terms of each new or renewed ACA, there is scope for greater consistency and improved monitoring and management of ACAs.

31. ACA guidance requires that an ACA taxpayer: has sound governance and tax risk management arrangements; and works with the ATO in an open

21 However, ACA holders include a number of the largest Australian corporate taxpayers, and as at 30 June 2014, ACA holders held 28 per cent of assets of all entities in the ATO's large market for income tax.

22 The ATO has not yet clarified whether to target ACAs to those taxpayers whose compliance behaviours can be improved or to reward those with stronger records of disclosure and compliance. It has also not clarified how to refine ACAs over time for taxpayers demonstrating a strong record of disclosure and compliance over a number of years.

and collaborative way, including through disclosure and ongoing dialogue about material tax risk.²³ In assessing taxpayers' governance and tax risk management arrangements, the ATO has differing approaches for the main tax types. The ATO advised that, given GST is a transaction based tax, having effective systems in place is more important for GST compliance than for income tax and fringe benefits tax (FBT) compliance, where compliance issues are usually the result of differing interpretations of the law by the taxpayer and the ATO. As such, the ATO is more reliant on the governance and systems of GST taxpayers and validates the governance and tax risk management arrangements of GST ACA holders annually. In contrast, it will accept written assurance from income tax and FBT ACA taxpayers as confirmation of sound governance and tax risk management. The ATO views these assurances as indications of whether significant tax issues are being considered and approved at appropriate levels in the organisation, and subject to proper review. Nevertheless, the ATO has not always followed this approach²⁴, and there is scope for the ACA Oversight Committee to more closely monitor and better align the administration of individual ACAs across business and service lines.

32. During the course of the year, many taxpayers have disclosed tax risks. The ATO advised of 41 income tax disclosures in 2013–14 involving transactions valued at approximately \$13.7 billion. However, it was not possible for the ANAO to readily confirm these transactions from the ATO's records, or to ascertain the ATO's response to the disclosures in many instances. Nevertheless, it was evident that ACA taxpayers have frequently used the ATO's interpretative assistance area to resolve areas of contention—the ATO advising that 167 private rulings²⁵ were sought by these taxpayers over the past three years. The extent of these disclosures and rulings indicates that ACAs have been useful in identifying and treating tax risks for participating taxpayers, albeit not always in 'real time' as ruling processes can be lengthy.

23 ATO, *Large Business Annual Compliance Arrangements* process map, available from <<https://www.ato.gov.au/Business/Large-business/In-detail/Compliance-and-governance/Annual-Compliance-Arrangements/>> [accessed 7 June 2014].

24 For example: one income tax ACA holder was only required to provide a governance letter before entering into the ACA and was not required to report changes to these arrangements each subsequent year of the ACA. Two GST ACA holders had a choice of providing a letter on an annual basis or having governance reviewed as part of their annual reviews.

25 A private ruling is binding advice that sets out how a tax law applies to you in relation to a specific scheme or circumstance.

33. The ACA annual review is the opportunity for the ATO and the ACA taxpayer to discuss major transactions and business events from the year, with a view to signing off those considered to be low risk by the ATO and developing mitigation strategies for those considered to be high risk. ANAO analysis of the annual review showed some variability across teams and business and service lines. For example, although all reviews considered risks, the three income tax review reports were most effective in considering the broader operation of the ACA. These reviews considered: interactions with the taxpayer; and other ATO activities such as compliance activity and private binding rulings. In two cases the steering committee responsible for the individual ACA did not meet to sign off the review year, only meeting if there was a dispute between the ATO and the taxpayer. In addition, the membership of the working group and the steering committee for one ACA taxpayer was the same, which essentially meant that the steering committee was endorsing its own work.

34. As indicated above, the ATO does not retain information related to disclosures in a consistent manner. Key ACA documents (including disclosures) are not consistently managed in accordance with the ATO's policy, and stored on the enterprise wide case management system. Rather, these documents can be in a variety of locations, making it difficult in some instances to view a full history of the ACA with the taxpayer. For three taxpayers, the ATO was not able to locate all documents relating to their ACAs.

35. An analysis of the time taken to complete the various stages of the ACA process also shows that the ATO is often not meeting its own timeliness targets. There would be benefits in including ACA cases in the ATO's enterprise wide quality assurance process or alternatively undertaking quality assurance at the business and service line level.

Summary of entity response

36. The ATO provided the following summary comments to the audit report.

The ATO welcomes the opportunity to comment on the ANAO report. The ATO accepts both recommendations and notes suggestions that have been made in the report where the ATO can further improve its administration of the Annual Compliance Arrangement (ACA) product.

It is noted that the ANAO acknowledges that an approach through Annual Compliance Arrangements or their equivalent is consistent with international practices of building cooperative relationships with larger corporate taxpayers.

It is pleasing that the report recognises that ACAs are well placed to be at the forefront of such a strategy as a complementary part of the ATO reinvention program.

Annual Compliance Arrangements were introduced in 2008 and there have been ongoing adjustments and evolution to ensure it is 'fit for purpose'. There has been regular feedback from large corporates as to the utility of these arrangements, which we have sought to respond to appropriately. However, we also acknowledge that it is time to refresh our approach to ACAs and, as identified in your report, we are in the final stages of an internal review of the ACA strategy. While we are yet to finalise our taxpayer consultation on the outcomes of this review, we envisage a renewed Annual Compliance Arrangement offer.

As part of this Annual Compliance Arrangement re-design work, the ATO will be further considering the broader compliance framework for large entities across all taxes to ensure a consistent and graduated compliance response to the tax risks profiles of all large business taxpayers. This should maximise taxpayers' ability to voluntarily address tax risks as they are identified, as well as provide an appropriate and proportionate enforcement response, if voluntary compliance cannot be achieved.

In following through on this design work, the ATO will ensure that the new and revised approaches are appropriately supported with staff training and internal and external guidance materials where required. We will also ensure that, for reporting and record keeping purposes, success factors, outputs and outcomes are clearly articulated to our staff to allow much more effective measurement and evaluation in the future

We acknowledge that the report identifies that there has been a low number of Annual Compliance Arrangements relative to the number of large corporates that may be suitable for such arrangements. However, the ATO believes that the number of ACAs currently being managed reflects the voluntary nature of the ACA arrangements and large corporates can choose to enter or not enter into such arrangements. As indicated in the report from interviews conducted by the ANAO, large corporates make their own assessment of the benefits and costs that they see in entering into such an arrangement.

While noting the need for a clearer expression as to the level of desirable take-up in the total number of Annual Compliance Arrangements, we believe the total number of taxpayers likely to meet our criteria is far less than the 158 key taxpayers. A realistic figure may well be in the range of 35-50 of these key

taxpayers but we will further consider this approach as we implement the recommendations of the report.

We have benefited enormously from taxpayers' participation in the ACA program. We have applied some of the experiences from the ACA program to other large business compliance approaches – for example pre-lodgment compliance reviews, risk workshops and key taxpayer reviews. It has also helped us improve our understanding of large business governance and tax risk management approaches. This understanding is helping us now to develop our work on compliance self-assurance models and pilots such as the external compliance assurance process.

With respect to resourcing of the ACAs, because of the size and influence of the large corporates who are in ACAs, there will always be costs associated with our compliance approaches, regardless of whether or not they are participating in the ACA program. We will work on improving how we identify the net costs or benefits of an ACA as part of our future program, in line with comments made in this report.

Recommendations

Recommendation No. 1

Paragraph 3.39

To better tailor ACAs to taxpayers' assessed compliance risks, the ANAO recommends that the ATO reassesses: the design of these arrangements within the compliance framework for large corporate taxpayers; the level of compliance assurance required to provide benefits for both parties; and the administrative processes.

ATO response: *Agreed.*

Recommendation No. 2

Paragraph 4.42

To support ongoing assessment of the effectiveness of ACAs to identify and mitigate tax risks in real time, the ANAO recommends that the ATO enhance its record keeping of taxpayers' disclosures of contentious tax positions, and the strategies developed to deal with these disclosures.

ATO response: *Agreed.*

Audit Findings

1. Background and Context

This chapter provides background information on the Australian Taxation Office's annual compliance arrangements with large corporate taxpayers. It also outlines the audit approach, including the objective, criteria, scope and methodology.

Introduction

1.1 The Australian Taxation Office (ATO) is responsible for administering Australia's taxation and superannuation systems. It seeks to build confidence in its administration by helping people understand their rights and obligations, improving ease of compliance and access to benefits, and managing non-compliance with the law. The ATO's administration covers a broad range of taxpayers, including individuals, small businesses and large corporate taxpayers.²⁶

1.2 Of the \$311.5 billion in net tax collected in 2012–13, the ATO advised that large corporate taxpayers contributed around \$155.5 billion (49.9 per cent). The tax behaviour of these entities is integral to the health of Australia's tax system, with potential consequences for the total revenue collected should they fail to meet their tax obligations.

1.3 The ATO's compliance model provides the framework for assessing taxpayers risk of non-compliance and developing responses according to the nature and level of identified risk, the causes of non-compliance and the level of cooperation of the taxpayers. For large corporate taxpayers, the ATO also aims to differentiate its compliance approach and level of engagement according to categories of risk—higher risk, key taxpayers, medium risk and lower risk assessed through its Risk Differentiation Framework.²⁷ Particular focus is given to the larger entities within this group as any non-compliance will potentially have higher consequences for revenue. In 2013–14, of the 1100 entities in the ATO's 'large market', 158 were categorised as 'key' as they

26 Most large corporate taxpayers are companies but others are government departments, partnerships, trusts, non-profit organisations and superannuation funds, all with annual turnover greater than \$250 million. As at June 2014, around 1100 entities were in this sector.

27 The Risk Differentiation Framework is a modelling tool that provides a relative risk profile of a population of taxpayers. Through the framework, the ATO estimates the likelihood and consequence of non-compliance with tax obligations to establish an overall risk categorisation for each taxpayer, which provides the basis for determining the compliance activities the ATO will undertake for that taxpayer.

were assessed as having a low likelihood of not meeting their tax obligations, but the amount of their tax liability means that any incorrect payment could have serious consequences for overall tax revenue. Because the significant majority of the 'large market' segment were rated as lower or medium risk (89 per cent in 2013–14) and three taxpayers were categorised as high risk, they were not eligible to be offered an annual compliance arrangement (ACA) on the criteria determined by the ATO.

1.4 While continuing to undertake a program of retrospective risk reviews, audits and other compliance activities across the risk categories²⁸, in recent years the ATO has increased efforts to build cooperative relationships with large corporate taxpayers, particularly those rated as 'key'. These relationships aim to support full and open disclosure of contestable tax positions, and the identification and mitigation of tax risks in 'real time'. This approach reflects the ATO view that most large corporate taxpayers are willing to comply, but that ongoing monitoring will assist in clarifying contestable positions²⁹ in real time.³⁰ To this end, the ATO's interpretative assistance activities are also important, in particular private binding rulings that clarify the ATO's view of contestable positions.³¹

1.5 Within the context of the ATO seeking to develop increased cooperative compliance relationships with the larger corporate taxpayers, key developments have been the:

- introduction of forward compliance arrangements (FCAs) in 2005. FCAs were voluntary arrangements between the ATO and large corporate taxpayers that established how they would work together, with the aim of providing greater certainty for these taxpayers on their tax matters and reducing the need for costly audits. FCAs marked a new cooperative approach with the ATO;

28 The ATO scans the tax returns of all large corporate taxpayers through a variety of risk filters, and conducts formal risk reviews of around 30 per cent of these taxpayers, with 18 per cent of this group subject to an audit. ATO, *Large business and tax compliance*, p. 4.

29 Contestable tax positions do not necessarily result in non-compliance. These positions arise from the complexity of the applicable legislation and the associated uncertainty that can arise from its application to arrangements in this market segment. Inspector-General of Taxation, *Review into aspects of the Australian Taxation Office's use of compliance risk assessment tools*, October 2013, p. 63.

30 Alternatively, ongoing audit or review of higher risk taxpayers will assist the ATO to address potential non-compliance, including in relation to opportunistic tax planning.

31 A private ruling is binding advice that sets out how a tax law applies to you in relation to a specific scheme or circumstance.

- launch of ACAs in May 2008. Similar in purpose to FCAs and still a voluntary arrangement, ACAs are intended to provide more practical certainty for large corporate taxpayers by enabling the review and management of tax risks in real time, but with less administrative demands; and
- development and staged implementation of the Risk Differentiation Framework commencing in 2008–09, for assessing the compliance risks associated with those taxpayers with extensive tax obligations, including high wealth individuals and large corporate taxpayers.

Annual compliance arrangements

1.6 ACAs are voluntary arrangements that the ATO negotiates with large corporate taxpayers to define and govern the compliance relationship. Initially established for three years, ACAs can be extended by agreement between the parties. The potential benefits to the taxpayer and to the ATO of entering into an ACA are shown in Table 1.1.

Table 1.1: Potential benefits of entering into an ACA

Taxpayer	ATO
<ul style="list-style-type: none"> • speedier resolution of technical issues (in real time); • administrative solutions to resolve compliance irritants; • centralised points of contact and ongoing dialogue on technical matters; • closure of prior periods, including legacy issues; • concessional treatments of penalties and interest; • development of a plan outlining agreed processes and timelines; • possibility of extension of thresholds for correcting GST mistakes; and • not being subject to other compliance activities (as outlined in paragraph 1.12). 	<ul style="list-style-type: none"> • real-time risk assessment of transactions at a time when it would not otherwise see them, that is before the tax return is lodged; • improved capability through looking at current issues, new products and issues; • a more facilitative rather than reactionary approach; and • reduction in staffing once the ACA is bedded down, for example, a compliance team can operate with 70 per cent of the previous staffing levels.

Source: ATO.

1.7 The criteria for selecting large corporate taxpayers to enter into an ACA have changed since they were established in 2008. Initially, the option of entering into an ACA was limited to the 50 largest entities, based on the value of their annual turnover. Taxpayers that had an FCA in place were given the option of rolling the arrangement into an ACA when the FCA expired.

Commencing in 2011–12, only those large entities assessed through the Risk Differentiation Framework as key taxpayers are considered potentially suitable for an ACA. The ATO informs large corporate taxpayers of its overall assessment of their relative risk of non-compliance, including if they are rated as potentially suitable for an ACA. It is open to these taxpayers to initiate discussions with the ATO to enter an ACA.

1.8 ACAs are built around the ATO’s assessment that particular taxpayers have sound governance processes to support meeting their tax obligations, and a commitment to ongoing disclosure of tax matters as they arise. While not overriding the application of tax laws and policies, ACAs provide greater practical certainty for taxpayers in relation to their tax positions as the ATO will consider tax risks in real time. In this way, ACAs are intended to offer a ‘no surprises’ approach, with potential benefits to both the ATO and the taxpayer.

1.9 Five types of taxes may be covered by an ACA: income tax, GST, excise, petroleum resource rent tax (PRRT), and fringe benefits tax (FBT).³² A taxpayer may negotiate an ACA for a single tax or for any combination of these taxes. An ACA for multiple taxes will include a separate schedule for each tax, which is negotiated and managed individually.

1.10 As at July 2014, the ATO had ACAs with 24 entities: 18 large companies³³, five state government departments, and one Australian Government entity. Of the ACAs established since 2008, all but one is ongoing.³⁴ The total number of large corporate taxpayers with an ACA from 2008–09 to 2013–14 is shown in Table 1.2. The total number of taxpayers with an ACA in any year reflects only a small proportion of those that are assessed by the ATO as potentially suitable for an ACA. Table 1.2 also shows the number of taxpayers assessed as potentially suitable for an ACA following the introduction of the Risk Differentiation Framework.

32 ACAs for minerals resource rent tax are not being further developed as the tax has been abolished.

33 Two of the ACAs relate to one taxpayer ‘group’, which has one ACA for its Multiple Entry Consolidated group and another for its Permanent Establishment in Australia.

34 One taxpayer’s ACA was not renewed when it expired in 2011.

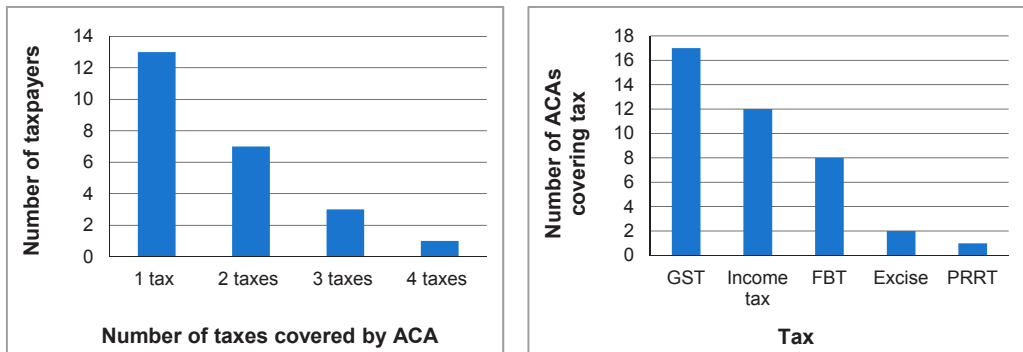
Table 1.2: Number of taxpayers with an ACA and those assessed as potentially suitable for an ACA for the period, 2008–09 to 2013–14

Year	2008–09	2009–10	2010–11	2011–12	2012–13	2013–14
Taxpayers with an ACA	3	8	17	18	20	24
Taxpayers assessed as potentially suitable for an ACA	50	100	100	135	163	158

Source: ATO.

1.11 Of those taxpayers with an ACA as at June 2014, 13 were for a single tax while 11 were for two or more taxes. Most of the ACAs in place relate to GST (17 arrangements), with 12 for income tax, eight for FBT, two for excise, and one for PRRT. The number of taxpayers that have entered into ACAs, the number of taxes each covers and type of tax are set out in Figure 1.1.

Figure 1.1 Taxpayers with an ACA, by number of taxes covered and type of tax



Source: ANAO analysis.

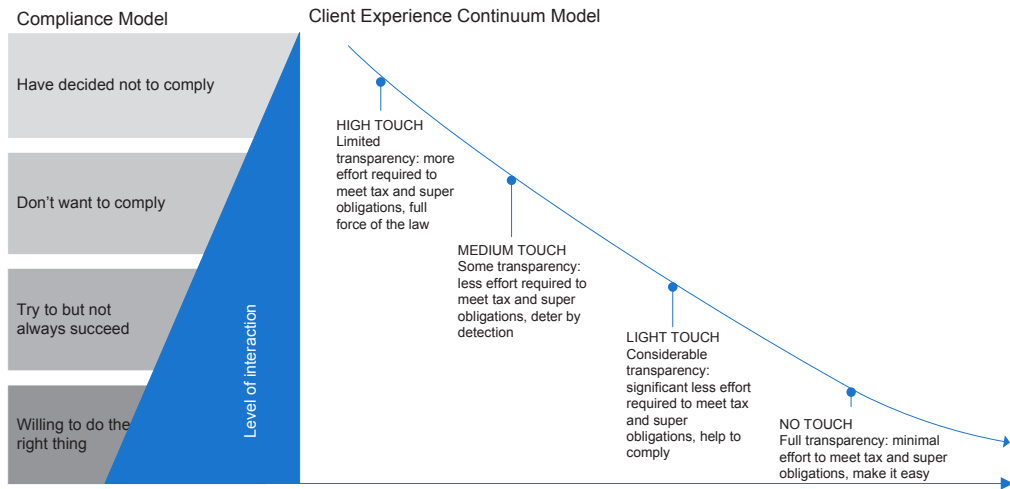
1.12 The ATO considers ACAs to be ‘the centrepiece of our efforts to build enhanced positive relations with large business’.³⁵ Voluntarily entering into an ACA will preclude the taxpayer from being subject to the following alternative compliance approaches:

- pre-lodgment compliance reviews—used to identify and assess large corporate taxpayers’ income tax risks in the pre and post-lodgment periods;
- reportable tax position schedules—many large corporate taxpayers are required to disclose their more contestable and material income tax positions; and
- key taxpayer reviews—piloted in 2013–14 for GST and excise, and implementation will be considered during the development of the 2014–15 Compliance Plan.

1.13 The ATO also has ongoing engagement with industry to further develop approaches to addressing tax risks that support its direction for managing tax compliance, as set out in the ATO’s 2020 vision.³⁶ The 2020 vision embraces the concept of real-time engagement, with approaches tailored to the level of risk associated with different taxpayers and the effective allocation of the ATO’s resources. On this basis, the level of effort required by a taxpayer to meet their taxation and superannuation obligations would reflect their willingness to comply, as set out in Figure 1.2.

35 Speech by the then Commissioner of Taxation: ‘A new dimension’, delivered at the Corporate Tax Association Convention, Sydney, 12 May 2008.

36 The ATO’s 2020 vision refers to the strategies and principles underpinning the ATO’s administration of the tax and superannuation systems in moving towards the year 2020 and a lighter or no touch experience for taxpayers.

Figure 1.2 Client experience continuum model

Source: ATO, 2020 vision.

ATO arrangements for administering ACAs

1.14 The ATO's administration of Australia's taxation and superannuation systems are centred around three groups³⁷ and the business and service lines (BSLs) within these groups. ACAs are administered in the Compliance Group, by the BSL responsible for the category of tax involved.

1.15 The ATO has developed a three-phase process for administering ACAs, which involves:

- entry into the ACA—where the taxpayer's governance arrangements are considered and a terms of arrangement document developed that sets out how the ACA will work;
- administration throughout the year—where the taxpayer can disclose material tax risks and the ATO will review these disclosures; and
- closure at the end of the financial year—where the ATO and taxpayer jointly review the taxpayer's tax return. The ATO provides sign-off for

³⁷ The groups are the: Compliance Group, which has responsibility for ensuring maximum levels of taxpayers' compliance; People, Systems and Services Group, which provides a range of corporate services across the ATO, including the development and maintenance of the ATO's information technology systems; and the Law Design and Practice Group, which provides corporate legal services.

low risk issues and develops mitigation strategies for higher risk issues.³⁸ The renewal of the ACA is also covered during this stage.

1.16 Negotiating and managing ACAs is the responsibility of operational staff within the relevant BSL. The document setting out the agreed terms of the ACA (including the governance arrangements, duration, commitments, disclosures, records, issues registers and dispute resolution mechanisms), is usually signed by the Commissioner of Taxation (the Commissioner) and the entity's Chief Executive Officer or Chief Financial Officer. Some ACAs establish a steering committee for each tax type (10 cases), while most establish one steering committee to oversee all taxes covered by the ACA (14 cases). There is also a working party for each ACA, comprising senior representatives from the ATO and the taxpayer.

1.17 High-level management is provided through the ATO's ACA Oversight Committee, which includes senior executive staff from the BSLs administering ACAs, reporting directly to the respective Deputy Commissioners in the Compliance Group.

Reviews of annual compliance arrangements

Internal ATO reviews and consultations

1.18 Commencing in late 2012, ACAs have been the subject of four ATO internal reviews, commissioned by the Public Groups and International (PG&I) and Indirect Tax (ITX) business lines, as well as consultation with key stakeholders. The reviews and consultations are the:

- *Review of Annual Compliance Arrangements*, completed in November 2012;
- *PG&I ACA Community Involvement Workshop*, conducted in February 2014;
- *Annual Compliance Arrangements Strategy Review (GST)*, commissioned in January 2014; and
- *Annual Compliance Arrangements (ACA) Review*, commissioned in January 2014 and at draft report stage as at September 2014.

38 These phases are outlined in the ATO, *Large Business Annual Compliance Arrangements* process map (discussed in Chapter 4). It is available from <<https://www.ato.gov.au/Business/Large-business/In-detail/Compliance-and-governance/Annual-Compliance-Arrangements/>>, [accessed 7 June 2014].

1.19 The PG&I business line's *Review of Annual Compliance Arrangements*, November 2012, identified a significant degree of inconsistency in the way that income tax ACAs are managed, including:

- the way the ACA concept was communicated to the taxpayers and the teams;
- uncertainty in the interpretation of clauses within the ACAs;
- an absence of meaningful guidelines; and
- an absence of active leadership from a central authority that could directly engage with the teams on issues ranging from the drafting of the arrangements to the management of the ACA.

1.20 The *PG&I ACA Community Involvement Workshop* conducted in February 2014 assessed six income tax ACA cases and also reviewed and augmented the outcomes from the November 2012 review. The report presented 22 recommendations covering four areas of concern: entry and exits into an ACA; staffing and support; policy and process; and the quality framework.

1.21 The *ACA Strategy Review (GST)* undertaken by the ITX business line in April 2014 examined the strategic positioning of ACAs. The key finding was that the administration of ACAs does not align with the ATO 2020 vision of a lighter touch for those entities with a strong record of disclosure and compliance.

1.22 The *Annual Compliance Arrangements (ACA) Review* considered the findings and recommendations of the previous reviews and examined ACAs with regard to, among other things, the direction of the ATO's approach to compliance, and the interaction with the compliance arrangements introduced after ACAs were established. The September 2014 draft review report noted that the other internal reviews have revealed 'several operational and strategic concerns with the way ACA's are being applied as a real-time compliance product', particularly their relatively high cost in the start-up years.³⁹ The findings of these reviews are discussed throughout this report.

39 ATO, *Annual Compliance Arrangements (ACA) Review*, September 2014, p. 6.

External review of ACAs

1.23 In August 2012 the Inspector-General of Taxation published the *Review into Improving the Self-Assessment System* which referenced ACAs.⁴⁰ The Inspector-General's concerns and observations included:

- ACAs are costly and require substantial additional work. These costs can be disproportionate where taxpayers have adequate governance systems in place, and explain the low take up of ACAs;
- refinements could be made to ACA processes to make it less resource intensive and the benefits more accessible, with a view to widening the availability of the process to other taxpayers; and
- taxpayers confirmed benefits in terms of having improved access to ATO staff and obtaining administrative certainty, but these benefits related mainly to uncontroversial issues. Further, where signoffs were qualified with 'no further action at this time', this did not give sufficient certainty as the ATO could re-examine the issues at a later time.

1.24 The report made the following two recommendations in relation to the administration of ACAs:

- to make ACAs more widely available to taxpayers through the ATO publicly communicating the expected administrative demands of entering into and maintaining an ACA as well as the expected benefits; and
- to appropriately address the expected increase in ATO workload⁴¹ with respect to ACAs and reduce timeframes and compliance costs associated with ACAs by considering overseas models.

The ATO agreed to these recommendations.

International experience

Organisation for Economic Co-operation and Development

1.25 In July 2013, the Organisation for Economic Co-operation and Development (OECD) examined the relationship between large corporate taxpayers and revenue bodies and published its report, *Co-operative Compliance:*

40 Inspector-General of Taxation, *Review into Improving the Self-Assessment System*, August 2012.

41 If ACAs were to become an attractive option there may be concerns with the ATO's ability to appropriately deal with the increased demand.

a Framework—From Enhanced Relationship to Co-operative Compliance. The report listed 24 countries⁴², including Australia, as having collaborative and trust-based relationships between large corporate taxpayers and revenue bodies.⁴³

1.26 The report noted that cooperative compliance arrangements can assist revenue agencies to improve compliance by large corporate taxpayers. In this regard, the OECD highlights the importance of transparency, disclosure and good governance systems on the part of both parties to reduce uncertainties over entities' tax positions. The OECD also considers that cooperative compliance can help to restore trust and confidence in the relationship between business and tax administrations.⁴⁴ While recognising concerns about compatibility of the approach with equality before the law, the OECD concluded that cooperative compliance is entirely consistent with modern compliance risk management principles.

1.27 Jurisdictions, including the United Kingdom and Ireland, that carried out a qualitative evaluation of their cooperative compliance programs indicated the following main benefits:

- no surprises on either side;
- a better and real-time information position;
- greater certainty in relation to forecasting tax yield and accurate and timely tax returns and payments;
- faster resolution of issues from committed parties; and
- enhanced and more open relationship between the revenue body and the taxpayer.⁴⁵

1.28 The most common benefits to the taxpayer were cited as improved compliance, lower compliance costs and greater certainty. The report included a recommendation that measures of effectiveness need to be refined and

42 The countries included in the study were: Australia, Austria, Canada, Denmark, Finland, France, Germany, Hong Kong, Hungary, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Russia, Singapore, Slovenia, South Africa, Spain, Sweden, UK and USA.

43 OECD, *Co-operative Compliance: A Framework: From Enhanced Relationship to Co-operative Compliance*, 2013, pp. 22–24.

44 In recent years, there has also been considerable criticism of these relationships, and the capacity of tax administrations to address the aggressive tax practices of some multinational companies that shift profits between jurisdictions to minimise tax liabilities. *ibid.*, pp. 11–14.

45 *ibid.*, p. 83.

integrated into the assessment of the overall compliance strategy.⁴⁶ Of particular relevance to the ATO's administration of ACAs was that similar initiatives were being implemented in the United States of America and the Netherlands.

1.29 More broadly, the OECD reported that cooperative compliance arrangements can assist revenue agencies to improve compliance by large corporate taxpayers. In this regard, it highlights the importance of transparency, disclosure and good governance systems on the part of both parties to reduce uncertainties over entities' tax positions.

United States of America

1.30 The United States Internal Revenue Service (IRS) developed the Compliance Assurance Process (CAP) in 2005. The CAP was developed to avoid years of uncertainty about a large corporation's actual tax liability: IRS audits of the tax returns lodged by large corporations were taking, on average, four years to complete. With the CAP, the IRS and taxpayers agree on how to report tax issues before their return is filed. Compliant and cooperative taxpayers can receive a streamlined IRS review of their tax return through its 'Compliance Maintenance' process.

1.31 The United States Government Accountability Office (GAO) assessed the CAP process and in August 2013 released its report *Corporate Tax Compliance: IRS Should Determine Whether Its Streamlined Corporate Audit Process is Meeting Its Goals*. The report noted that while anecdotal evidence indicated that CAPs may be effective in ensuring compliance, increasing certainty and saving resources, the IRS had not succeeded at assessing whether or not the CAP was achieving its goals. Recommendations made by the GAO included that the IRS: evaluate the process; develop measures and targets for the goals; and consistently capture data to track goal progress.⁴⁷

Netherlands

1.32 ACAs are similar to the horizontal monitoring approach undertaken by the Dutch Tax Administration. Horizontal monitoring is based on mutual trust, transparency and understanding, with respective roles and responsibilities set out in a mutual agreement.

⁴⁶ *ibid.*, p. 88.

⁴⁷ GAO, *Corporate Tax Compliance: IRS Should Determine Whether Its Streamlined Corporate Audit Process Is Meeting Its Goals*, August 2013, p. 27.

1.33 In 2011, the Netherlands State Secretary for Finance established an independent Committee to evaluate the horizontal monitoring program to measure the results and success of the program and make recommendations for future development. The Committee released its report *Tax Supervision—Made to Measure* in June 2012.

1.34 The report confirmed the advantages of greater transparency, speedier certainty and increased mutual understanding for the revenue body. As to whether compliance costs have decreased, the Committee observed satisfaction from taxpayers in the very large business segment, however, there was no empirical data to support this. The Committee recommended that appropriate performance indicators be developed as, on the information available, it could not answer the question of whether horizontal monitoring was effective and efficient.⁴⁸

Audit objective, criteria, scope and methodology

Objective and criteria

1.35 The objective of the audit was to assess the effectiveness of the Australian Taxation Office's administration of annual compliance arrangements with large corporate taxpayers.

1.36 To form a conclusion against this objective, the ANAO adopted the following high-level criteria:

- the governance arrangements for ACAs are well planned and effective;
- there are sound processes for selecting entities to enter into an ACA;
- results achieved to date reflect initial expectations of ACAs; and
- individual ACAs are effectively administered, in accordance with internal policies and procedures, to achieve intended benefits.

48 Professor Dr E.C.J.M. van der Hel-van Dijk and Professor Dr M. Pheijffer, A Tailor-Made Approach to Fiscal Supervision: An Evaluation of Horizontal Monitoring, *Bulletin for International Taxation*, 2012 (Volume 66) No 10.

Scope and methodology

1.37 The focus of the audit was on large corporate taxpayers with an ACA in place, and potentially suitable taxpayers that had chosen not to enter into an ACA.

1.38 The audit methodology included consulting with taxpayers and industry groups, interviewing ATO staff and examining relevant documentation and systems. The ATO’s case management system was analysed in relation to each ACA in place.

1.39 The audit has been conducted in accordance with the ANAO’s auditing standards at a cost of approximately \$478 000.

Structure of the report

1.40 Table 1.3 outlines the structure of the report.

Table 1.3: Structure of the report

Chapter and title		Overview of chapter
2	Management Arrangements	Examines the ATO’s management arrangements supporting the administration of ACAs.
3	Positioning of ACAs within the ATO’s Compliance Framework	Examines the processes to identify, encourage and select taxpayers suited to entering an ACA, and the positioning of ACAs in the ATO’s compliance framework for large corporate taxpayers.
4	Administration of ACAs	Examines the ATO’s administration of ACAs.

2. Management Arrangements

This chapter examines the ATO's management arrangements supporting the administration of ACAs.

Introduction

2.1 The introduction of forward compliance arrangements in 2005, followed by ACAs in 2008, reflects the ATO's commitment to establishing cooperative relationships with selected large corporate taxpayers, and assisting them to manage their tax risks and tax compliance in real time. While the intent of the arrangements has not changed, aspects of the management and operation of ACAs have been further developed since they were introduced. Organisational restructures have also affected management arrangements, with the ACA Oversight Committee being established in 2012. In addition, there have been changes to internal and external monitoring and reporting arrangements as well as efforts to evaluate the success of ACAs in achieving their expected benefits.

2.2 To assess the effectiveness of the ATO's management of ACAs, the ANAO examined the:

- management structure supporting ACAs, including the role of the ACA Oversight Committee;
- management information and external reporting of ACAs; and
- evaluation of the effectiveness of ACAs in achieving their expected benefits.

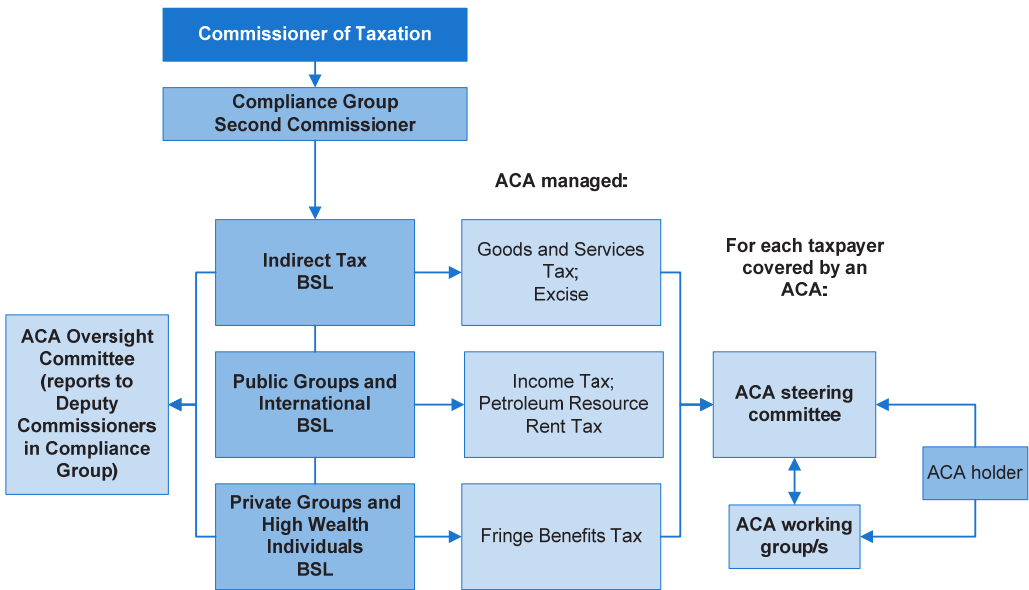
Management structure

2.3 Management of ACAs is largely undertaken by the following BSLs in the ATO's Compliance Group:

- Indirect Tax (ITX) manages ACAs for GST and excise;
- Public Groups and International (PG&I) manages ACAs for income tax and PRRT; and
- Private Groups and High Wealth Individuals (PGH) manages ACAs for FBT.

2.4 The structure of the Compliance Group, and the management of ACAs by each BSL, is set out in Figure 2.1.

Figure 2.1: Structure of the Compliance Group, June 2014



Source: ANAO from ATO documentation.

2.5 From August 2013, the structure of the work managed by the Compliance Group changed from BSL responsibilities largely based on entities' turnover, to greater alignment with the structures and legal frameworks that exist in the market sectors. The new structure recognises that different entities have different governance and reporting requirements, and that the ATO's compliance approaches could be better tailored to their specific circumstances.⁴⁹ To this end, the ATO has created a matrix structure to manage tax compliance, based on the type of tax and the market segment, for example: the ITX BSL manages all entities' indirect and excise taxes; PG&I BSL manages income tax and PRRT for public groups and internationals; and PGH BSL manages taxes (including income tax) for this market segment and FBT for all segments.

2.6 The restructure has also changed the number of entities managed by the three BSLs. PG&I managed approximately 31 000 entities as at June 2014, including approximately 1100 large businesses that had previously been the

49 Commissioner of Taxation, 'Reinventing the ATO', speech delivered at the Tax Institute of Australia 29th National Convention, Hobart, 27 March 2014.

sole responsibility of the (then) Large Business and International BSL, the smaller public entities previously managed in the Small and Medium Enterprises BSL and small enterprises in the Micro Enterprises and Individuals BSL. PGH now manages those large private entities previously in the Large Business and International BSL and is responsible for the administration of FBT which previously fell under the Small and Medium Enterprises BSL. The ITX BSL continues to manage all indirect taxes across all taxpayers.

2.7 Irrespective of the new ATO structure, as previously noted ACAs have always been administered by different BSLs depending on the type of tax, particularly income tax, GST and FBT. The ATO has recognised (and the recent internal reviews have reinforced) that administering ACAs across three BSLs has generated inconsistency in the negotiation, operation and sign-off of the arrangements.⁵⁰ While some steps have been taken to improve the consistency of administration, such as the establishment of the ACA Oversight Committee in June 2012, a lack of coordination across BSLs was still being identified as an issue by the ATO in June 2014.

ACA Oversight Committee

2.8 The ACA Oversight Committee was established following concerns from staff in the three BSLs administering ACAs about the overarching and day-to-day governance and decision-making processes for ACAs across the BSLs. The Committee was established to ensure a robust governance framework and a 'one ATO approach to ongoing implementation of the ACA product'.⁵¹ Membership of the Committee includes senior executive staff from the BSLs managing ACAs, with reporting obligations to the Deputy Commissioners in the Compliance Group.

2.9 The terms of reference for the ACA Oversight Committee are set out in the Committee's charter, endorsed on 25 October 2012, and include:

- developing a framework for the implementation and governance of ACAs;
- developing policies and supporting procedures to ensure that taxpayers are suitable for entry into an ACA; and

50 ATO, *Annual Compliance Arrangement Review*, draft, September 2014.

51 ATO, *Concept Brief, Establishing an ACA Oversight Committee*, 30 March 2012, p. 5.

- ensuring that ACAs are an integral part of the compliance strategy for the large market.

2.10 The Committee's terms of reference required it to focus initially on the 35 taxpayers that had been offered an ACA in 2011–12 to assess the take up rate and appropriate tailoring of ACAs; and to evaluate the effectiveness of ACAs. Essentially, the Committee was to develop a suite of administrative measures for ACAs, including developing a governance framework, strategy and effectiveness measures.

Operation of the ACA Oversight Committee

2.11 The ACA Oversight Committee primarily operates through its monthly meetings. As at 30 June 2014, the Committee had met on 25 occasions. The ANAO reviewed the minutes of the meetings held from June 2012 to May 2014. The minutes reflect discussions on key issues relating to the administration of ACAs, as set out in its charter, and a rolling list of action items. However, the minutes also reveal that several of the key items of work relating to the management of ACAs and the role of the Committee had either been substantially delayed or not been completed. Specifically, the:

- work program for the Committee, originally due by July 2012, was presented to the Committee on 26 June 2014;
- revised large business ACA process map⁵², originally due by October 2013, had similarly been delayed due to competing work priorities, but discussed at the 29 May 2014 meeting where it was decided it would be held over pending the outcome of further reviews; and
- performance framework and effectiveness measures project for ACAs, commenced in November 2012, and was scheduled for completion in late-2014.

2.12 More generally, the meeting minutes indicate that the Committee was aware of many issues concerning the administration of ACAs but was taking some time to implement remedies, such as developing an overarching strategy for ACAs, and refining policies and supporting procedures for these arrangements.

52 The large business ACA process map explains the key features of ACAs.

2.13 While some common aspects of ACAs have been developed through the Committee, in practice BSLs have established their own arrangements for managing ACAs. At a high level, the processes for negotiating an ACA are similar in each BSL (for example, the terms and conditions of the arrangements, and governance assurance letters), but key components of the ACAs differ between the BSLs and often between teams within a BSL. As discussed in Chapter 4, differences include the management of issues registers, end of year reviews, and sign-off of the annual tax return. The arrangements are designed to allow a degree of flexibility to accommodate the different payment schedules and complexities associated with the various taxes subject to an ACA. However, the terms of reference for the Committee acknowledge the benefits of more consistency in processes and improved knowledge and information exchange across BSLs.⁵³

Resourcing arrangements for administering ACAs

2.14 The ATO has not sought additional funding through the budget processes to support the introduction and ongoing management of ACAs, and no staff are allocated solely to their administration. Rather, ACAs are supported as part of the work of staff in the ATO's compliance teams.

2.15 As at 30 May 2014, data provided by the ATO indicated that 26.5 full time equivalent staff (FTE) were working on the administration of ACAs: 18 FTE for income tax, six for GST and excise, two for PRRT and 0.5 for FBT.

2.16 The ATO's expectation that there would be a reduction over time in the resources necessary to manage ACAs has generally not materialised. Rather, there has been a fairly constant and relatively high workload associated with the annual sign-off process, and when renewing arrangements. For example, a compliance team managing an ACA advised the ANAO it had become a de facto lead relationship manager for the ATO in dealing with the company, which can be time consuming.⁵⁴

53 Administration of ACAs is discussed in Chapter 4.

54 A later section in this chapter, and Chapters 3 and 4, discuss aspects of the resource imposts of ACAs for the ATO and taxpayers.

Training and guidance

2.17 The ATO provides guidance material on its intranet on the use of the case management system⁵⁵ for managing ACAs. Each BSL has different products in the case management system for their respective ACAs and the training provided to staff across the BSLs has been variable over the years. ATO officials advised that during the ACA pilot stage, the PG&I BSL developed a one-day training package for staff, as well as an information kit for visits by SES officers to the top 100 companies. The ATO advised that for the Client Relationship Managers⁵⁶ in the ITX BSL, a three-day training course is available which includes information on ACAs. For PRRT, documents were produced outlining the broad context of where the ACAs fit into the business, guiding principles, deliverables and interactions with the taxpayer.

2.18 Nearly half the compliance officers interviewed⁵⁷ during the audit advised that they had not received specific ACA training. Rather it has been a matter of learning on the job with the help of the instruction material on the intranet and advice from the ACA Oversight Committee Secretariat as required.

2.19 While representatives of large corporate taxpayers interviewed by the ANAO were generally satisfied with the level of service provided by ATO staff managing their ACA, several cited issues when there had been a change of manager. Over time, professional relationships had been established and matured.

2.20 Recent internal reviews conducted by the ATO have identified the need for improved guidelines to help ensure administrative practices for ACAs are applied consistently across BSLs.⁵⁸ These practices include negotiating ACAs, dealing with legacy issues such as GST implications of multi-party transactions, providing appropriate (not excessive) levels of administrative support, interpreting core ACA terms, examining disclosures and conducting the annual sign-off.

55 The electronic case management system is an enterprise-wide system used to manage cases and work items, and manage client relationship interactions arising from telephone calls and correspondence. The electronic case management system is supported by procedures and processes.

56 The ITX BSL appoints Client Relationship Managers for large public and privately operated entities with turnover of more than \$250 million.

57 Eleven of the 28 ATO officials interviewed advised they had received no specific training. The remaining 17 did not comment.

58 Similar comment was made to the ANAO by the ATO officials interviewed during the audit.

2.21 There would be benefit in the ACA Oversight Committee reviewing the current training and guidance material to ensure there is appropriate support for compliance officers managing ACAs, particularly in light of the move from the traditional audits and reviews to a more cooperative compliance approach.

Management and external reporting of ACAs

2.22 Each of the three BSLs produces its own management report on ACAs, which are primarily included in consolidated reports of compliance performance with respect to the taxes managed by the BSL. The key management reports focus on deliverables (outputs) or progress in addressing particular issues or administrative challenges, as shown in Table 2.1.

Table 2.1: ACA management reports, by business and service line

Type of report	Frequency
Public Groups and International (income tax)	
Report on income tax liabilities that are covered by an ACA	Monthly
Consolidated results set out the value of income tax compliance results for the year to date for taxpayers with an ACA	Monthly
Consolidated data on the value of transactions disclosed under an ACA and the value of unresolved risk	Monthly
PRRT work report prepared for the PRRT Assistant Commissioner	Monthly
Indirect Tax (GST and excise)	
Compliance performance report prepared for the Deputy Commissioner	Monthly
GST report that is also sent to the states and territories	Quarterly
Significant issues report to the Deputy Commissioner	Monthly
Items of note (dot points) across the large market to the Assistant Commissioner	Fortnightly
Private Groups and High Wealth individuals (FBT)	
Compliance team keeps Assistant Commissioner abreast of workload	Ongoing

Source: ATO.

2.23 These reports generally provide the senior executives in the respective BSLs with a regular update of the main contentious tax issues surrounding the administration of ACAs, an overview of the revenue associated with such issues and an update on the value of assessments amended through ACA processes. For example, in PG&I, the Deputy Commissioner was informed of the share of the large market covered by ACAs (around 28 per cent of assets as

at 30 June 2014), the value of risks under review and the tax amount involved (\$1 878 million and \$512 million respectively in 2013–14) and the value of tax adjustments (around \$82 million made in 2013–14).

2.24 The ACA Oversight Committee is also informed about operational matters (such as those ACAs being negotiated or renewed) and key issues and tax risks being addressed. However, it is not regularly informed of the broader outputs or outcomes of ACAs in achieving envisaged benefits.⁵⁹ To improve reporting to the Committee and senior ATO executives about key issues and outputs, an ACA register is being developed by the Committee secretariat. The register is designed to be provided to the Committee on a monthly basis including key facts for each ACA such as key dates, tax coverage, and emerging issues.

2.25 External reporting of ACAs has been through the Commissioner of Taxation annual reports 2008–09 to 2011–12. Information about the number of ACAs and value of tax assured by these arrangements was reported. For example, in 2011–12 it was reported that there were ‘18 annual compliance arrangements (ACAs) in place with large businesses, covering income tax, GST, excise and fringe benefits tax with \$260 billion in GST and \$100 billion in income covered by ACAs’. No information in relation to ACAs was provided in the 2012–13 annual report.

2.26 Overall, management reporting provides BSL executives with useful and timely information about the key issues and outputs associated with ACAs, and external reporting is appropriate to the scale of ACAs. However, there has been only limited progress to date in measuring the effectiveness of ACAs, as discussed below.

Evaluating the effectiveness of ACAs

2.27 The ACA Oversight Committee initiated work in 2012 to evaluate the effectiveness of ACAs in meeting their objectives.⁶⁰ After more than two years, this evaluation is scheduled for consideration in late-2014. While it had been intended to include income tax, GST, excise and PRRT, the evaluation has subsequently been undertaken for income tax ACAs only.

59 Further, the ACA Oversight Committee had not met its charter requirement to report on progress and outcomes of an endorsed work program on a quarterly basis to the Large Market Committee, prior to the Large Market Committee being disbanded in February 2014.

60 Rather than having stated objectives, the key documentation (particularly the *Large Business Annual Compliance Arrangements* process map) refers to the benefits of ACAs, to both the taxpayer and the ATO.

2.28 The ATO has also conducted a series of reviews into ACAs and associated compliance approaches for large corporate taxpayers, as noted in Chapter 1. These reviews have collected information largely from ATO compliance officers and executives about their experiences and perceptions of the benefits and effectiveness of ACAs.⁶¹ As part of the ACA review, in June 2014 the ATO surveyed suitable companies that had not entered into ACAs to ascertain the main reasons for them not participating. These various sources of information have provided a qualitative overview of the effectiveness of key aspects of ACAs, which the ATO has considered in the ACA review, and are discussed in paragraphs 2.32 to 2.38.

2.29 The ATO advised that it faces challenges in evaluating ACAs, such as measuring the additional revenue from, or improved compliance by, large corporate taxpayers as a result of ACAs, or concepts such as certainty and improved cost effectiveness.⁶² However, quantitative data is available to support analysis of changes in the tax paid by and compliance performance of taxpayers before and after entering into an ACA, and a range of qualitative information is also available. To provide a defensible opinion about the effectiveness of ACAs, the ATO could apply the principles and guidelines for conducting evaluations set out in its compliance effectiveness methodology.⁶³ Conducting such an evaluation that includes all relevant taxes may also help to determine the continuing relevance and positioning of ACAs.

ATO evaluation of effectiveness

2.30 In anticipation of the ATO's evaluation of ACA effectiveness being completed in late-2014, Table 2.2 outlines the interim evaluation findings as at August 2014.

61 The ATO also conducted a survey of ACA holders in 2011, mainly focussing on the costs to taxpayers. However, the primary feedback from the survey, that most respondents incurred no significant costs in entering into an ACA, is contrary to subsequent advice from ACA holders to the ATO and ANAO.

62 For the ATO, improved cost effectiveness encompasses the accurate, efficient, and timely resolution of complex tax issues. For taxpayers, cost effectiveness includes speedier resolution of technical issues in real time, as well as reduced staff and advisor costs required to deal with tax compliance.

63 The compliance effectiveness methodology is based on two key elements: identification of measurable compliance objectives; and articulation and treatment of the risks to achieving them. See ANAO Audit Report No.39 2013–14, *Compliance Effectiveness Methodology*, available from http://www.anao.gov.au/~media/Files/Audit%20Reports/2013%202014/Audit%20Report%2039/Audit_Report_2013-2014_39.pdf, [accessed 7 July 2014].

Table 2.2: ATO evaluation of ACA effectiveness, interim findings as at August 2014

Evaluation criteria	Interim finding
Assure appropriate revenue is collected	Based on data collected to date, it appears an appropriate amount of revenue is being collected from ACA taxpayers.
Influence compliance behaviour	Some compliance teams felt that any material change in compliance behaviour may be due to prior compliance activity. Only one team reported the taxpayer had changed their original position on tax treatment. Other reported behaviour changes were: <ul style="list-style-type: none"> improved record keeping and information sharing regarding major transactions since taxpayers entered into an ACA; and taxpayers asking the ATO for an opinion on transactions before seeking external advice.
Improve cost effectiveness for the ATO	Mapping compliance FTE usage shows an increased use of resources before entry into an ACA with some tapering off. This is supported by views from ACA teams and senior executive service officers that setting up the ACA agreement is difficult, time consuming and resource intensive for the ATO.
Improve ATO understanding of taxpayer's business and its environment	Although ACA teams and SES officers consider they have an improved understanding of the individual ACA taxpayer's business, there is inconsistent reporting of intelligence. This suggests the ATO is not consistently sharing this knowledge to better understand, detect or deal with similar risks that might exist in the wider industry.
Supply intelligence	Other than procedures for the case management system, there is no consistency in the way the teams gather, share and deal with intelligence. There is ad hoc sharing of information and limited use of the corporate intelligence recording system <i>ATOintelligence Discover</i> . Intelligence gathering, dissemination and reporting needs improvement.
Improve risk management in cooperation with taxpayer	At the taxpayer level, sound risk management principles appear to be generally adopted, however only half the teams reported communicating directly with operational risk managers. This may be due to most of the potential risks identified being rated as low.
Improve cost effectiveness for the taxpayer	There is no evidence to support the proposition that ACAs are more cost effective for taxpayers. There was general acknowledgment that costs increased at the establishment phase, which for some taxpayers may be offset by indirect savings such as lower costs for seeking external tax advice. Non-ACA taxpayers reported costs to be a barrier. Other data suggests that ACA taxpayers perceive additional benefits that may outweigh any additional costs.
Provide the taxpayer with greater certainty	The number of rulings for ACA taxpayers increased generally and this was confirmed by teams and SES officers through interviews. However, there are concerns by ACA taxpayers that the ATO sign-off for ACAs may not be legally binding. Taxpayers were also concerned the sign-off is for one year and not the life of a transaction.

Evaluation criteria	Interim finding
Improve stakeholders' perceptions that ACA is working as intended	Internal ATO stakeholders considered ACA taxpayers are generally positive about ACAs. Views of taxpayers who have not entered into an ACA indicate that, from their perspective, the costs may outweigh the benefits.

Source: ATO.

2.31 Overall, the interim findings are that ACAs are generally working as intended although the overall benefits to be gained through entering into an ACA are not to the extent expected for taxpayers or the ATO. In particular, while ACA taxpayers are generally positive about ACAs, there is no evidence that the agreements have improved cost effectiveness for these taxpayers, while greater certainty is often being sought through private rulings.⁶⁴ From the ATO's perspective, ACA taxpayers are considered to be paying appropriate amounts of tax, but the ATO is not effectively using the intelligence gathered from administering these arrangements to strengthen compliance approaches more generally, and administration costs are relatively high particularly at start up. These interim evaluation findings are broadly confirmed by analysis conducted for this audit or from broader ATO reviews.

ANAO stakeholder interviews and broader ATO reviews

2.32 The ANAO conducted interviews with 25 entities that had an existing ACA or had previously held an ACA. Thirty entities that had not entered into an ACA despite being offered one in 2011–12 were also contacted and 12 entities provided feedback to the ANAO. The feedback from these interviews, together with findings from the ATO reviews, address the effectiveness of key elements of the administration of ACAs as outlined below.

Benefits from entering an ACA

2.33 In general, entities were satisfied with their ACAs. For them it is a relationship management arrangement that results in a higher level of service from the ATO. Many entities considered that having an ACA made the relationship less adversarial, increased the level of trust, and avoided the more onerous audits and reviews. There was also greater certainty about tax

64 Over the past three years, ACA taxpayers have sought 167 private rulings, covering GST (134 rulings), income tax (23 rulings) and FBT (10 rulings).

positions, some improved responsiveness of the ATO to resolving their issues, and benefits from threshold extensions and interest and penalty concessions.⁶⁵

Reasons for not entering an ACA

2.34 The extent of effort required at start-up and ongoing administrative demands were the main barriers to entering into an ACA. Many entities were also satisfied with their relationship with the ATO and did not see any additional benefit from having an ACA.

Cost effectiveness for taxpayers and the ATO

2.35 As previously noted, the costs of entering into an ACA were considered high relative to other compliance arrangements, particularly on initial entry and if any legacy issues were outstanding.⁶⁶ Some ACA holders had achieved savings due to their ability to obtain 'free' advice from the ATO in relation to the treatment of certain tax risks rather than having to pay external advisors. There was also general agreement of speedier resolution of issues, unless they were more complex, in which case extended periods were still required for resolution.

2.36 ATO reviews have found that ACAs generally require additional ATO resources compared with other compliance arrangements for large entities.⁶⁷ This is partly due to the need to provide sign-off within five months of lodgment of their annual tax return, something not required as part of, for example, the pre-lodgment compliance review process. These reviews have indicated that ACAs are often not cost-effective for the ATO, as the costs of administering an ACA can outweigh any benefits from improved real-time disclosures by compliant taxpayers.

Providing greater certainty for taxpayers

2.37 Although most ACA holders interviewed considered that an ACA increased the certainty of sign-offs, which effectively close off any further ATO reviews for all relevant tax returns and activity statements, some doubt

65 In the event of a tax shortfall, the ACA taxpayer receives concessionary treatment in certain circumstances in relation to penalties and the general interest charge. The concessionary treatment relating to different circumstances is explained in the ACA terms of arrangement signed with the taxpayer. For GST and excise, an ACA taxpayer also receives extended correcting thresholds (in relation to value and time) for genuine and reasonable mistakes.

66 Legacy issues are tax risks that arose some years ago and are still unresolved.

67 These findings were based on feedback from ATO staff administering ACAs rather than quantitative analysis of costs.

remained as the annual sign-off was not legally binding and instead based on good faith. There was concern that the ATO may still reverse its position, although no matters had been re-opened to date.⁶⁸ The other main issue raised was that the annual sign-off is qualified (that is, it only applies to a certain year under certain conditions). Taxpayers' expectations are that, if the ATO changes its view, that it will be prospective rather than retrospective. As outlined in the Inspector-General of Taxation's *Review into Improving the Self Assessment System*⁶⁹, administrative certainty relates to uncontroversial issues—an ACA does not give certainty for controversial issues, and taxpayers generally rely on rulings processes.⁷⁰

Assuring revenue collection and improving compliance

2.38 ATO internal reviews found little evidence to demonstrate that ACAs had increased compliance and revenues collected. The ATO advised the total values cooperatively assured during 2013–14 include GST throughput of over \$31 billion, total sales and purchases of \$523 billion, \$4.3 billion in excise revenue and \$10.9 billion in income tax revenue. Nevertheless, some ATO officials and entities that have entered into an ACA indicated that compliance may be higher under an ACA, particularly as many ACA holders tend to over-disclose to ensure all matters have been considered by the ATO when sign-off is granted.

Conclusion

2.39 The ATO has a framework for administering ACAs, based around the compliance teams in the three responsible BSLs with oversight from a coordinating committee. While the ACA Oversight Committee has discharged many of its responsibilities, it has been slow to progress initiatives designed to strengthen the ATO's administration of ACAs and to provide consistency in practices across BSLs. There would be benefit in the Committee reviewing the

68 The ATO issued a practice statement in 2011 dealing with 'U-turns'. The statement requires ATO staff not to devote compliance resources to implementing a changed view of the law retrospectively. Some taxpayers suggested that the 2013 Federal Court decision in the Macquarie Bank case had cast legal doubt on the ATO's ability to give effect to this principle outlined in the practice statement. The ATO, however, considers it has considerable practical scope to use the statement and is committed to the principles in it. Speech by the Commissioner of Taxation: 'Reinventing the ATO', delivered at the Tax Institute of Australia 29th National Convention, 27 March 2014, Hobart.

69 Inspector-General of Taxation, *Review into Improving the Self Assessment System*, August 2012, pp. 99–100.

70 Taxpayers can apply to the ATO for a private ruling. A private ruling is binding advice that sets out how a tax law applies to a taxpayer in relation to a specific scheme or circumstance. The ATO must administer the law in the way set out in the ruling, unless it later finds the ruling is incorrect and that applying the law correctly would lead to a better outcome for the taxpayer.

training and guidance material provided to officers managing ACAs in light of feedback from recent reviews about the core ACA terms, the operation of the ACA and its interaction with other ATO compliance arrangements.

2.40 Management reporting provides BSL executives with useful and timely information about the key issues and outputs associated with ACAs, and external reporting is appropriate to the scale of ACAs. However, ACAs were introduced six years ago, and the ATO has not yet systematically evaluated their effectiveness in providing the benefits envisaged. It is intended that an internal evaluation, due to be completed in late-2014, will report on the level of effectiveness of income tax ACAs. However, the evaluation needs to be broadened to include the other taxes as was originally envisaged.

2.41 Indications from ATO reviews, and ANAO consultation with ATO officials and stakeholders for this audit, are that ACAs have delivered benefits to participating taxpayers through higher levels of service and increased certainty of tax positions for more straightforward matters. However, although the actual costs of administering ACAs are not known, ATO and ACA holders consider administrative demands to have been relatively high.

3. Positioning of ACAs within the ATO's Compliance Framework

This chapter examines the processes to identify, encourage and select taxpayers suited to entering an ACA, and the positioning of ACAs in the ATO's compliance framework for large corporate taxpayers.

Introduction

3.1 Based on Australia's tax system of self-assessment and voluntary compliance, the ATO's approach to working with large corporate taxpayers is guided by the principles in the Taxpayers' Charter⁷¹ and the compliance model. The model provides the framework for assessing the risks of taxpayer non-compliance and developing responses according to the nature and level of identified risk, the causes of non-compliance and the level of cooperation of the taxpayers.⁷² Consistent with this model, there are a number of elements to the ATO's compliance framework for large corporate taxpayers. As outlined in Chapter 1, these include: standard audit and risk reviews⁷³; pre-lodgment compliance reviews; reportable tax position schedules; key taxpayer reviews and ACAs.

3.2 The ATO has consistently described ACAs as 'the centrepiece of our efforts to build enhanced positive relations with large business'.⁷⁴ As such, it is considered to be the premium real-time compliance arrangement within the ATO's cooperative compliance model—where self-assessment and cooperative compliance is seen as the cornerstone of the Australian tax system.⁷⁵

71 The Taxpayers' Charter sets out the way the ATO conducts itself when dealing with clients. It helps clients understand their rights, obligations and what they can do if they are not satisfied with the ATO's service or actions.

72 ATO, *Large business and tax compliance*, p. 7.

73 An audit is a specific or wide-ranging ATO examination to confirm that the correct amount of tax has been paid. Risk reviews can be preliminary or comprehensive and involve analysis of a taxpayer's private and business activities to determine if identified risks warrant further examination or treatment.

74 ATO, *Large business and tax compliance*, p. 20, available from <<https://www.ato.gov.au/Business/Large-business/In-detail/Key-products-and-resources/Large-business-and-tax-compliance-publication/>> [accessed 3 July 2014].

75 *ibid.*, p. 19. Cooperative compliance refers to a cooperative relationship between the ATO and large corporate taxpayers based on mutual respect and responsibility. It promotes the use of tailored responses to different taxpayer groups based on their compliance risk levels and histories.

3.3 As previously discussed, ACAs are voluntary arrangements that offer large corporate taxpayers potential benefits, such as greater practical certainty of their tax positions, concessional treatment for penalties and interest, and higher levels of accessibility to the ATO. In return, these taxpayers are required to have good governance and risk management processes as assessed by the ATO and to disclose tax risks in real time. Despite the recognised benefits, only 24 taxpayers had an ACA in place as at July 2014.

3.4 To assess the ATO's processes for selecting taxpayers for an ACA, and the role of ACAs in the ATO's compliance framework for large corporate taxpayers, the ANAO examined the:

- current approaches to identifying taxpayers for an ACA;
- efforts to encourage participation in the arrangement since its inception in 2008; and
- strategic positioning of ACAs in the compliance framework for large corporate taxpayers.

Identifying taxpayers suitable for an ACA

Risk Differentiation Framework

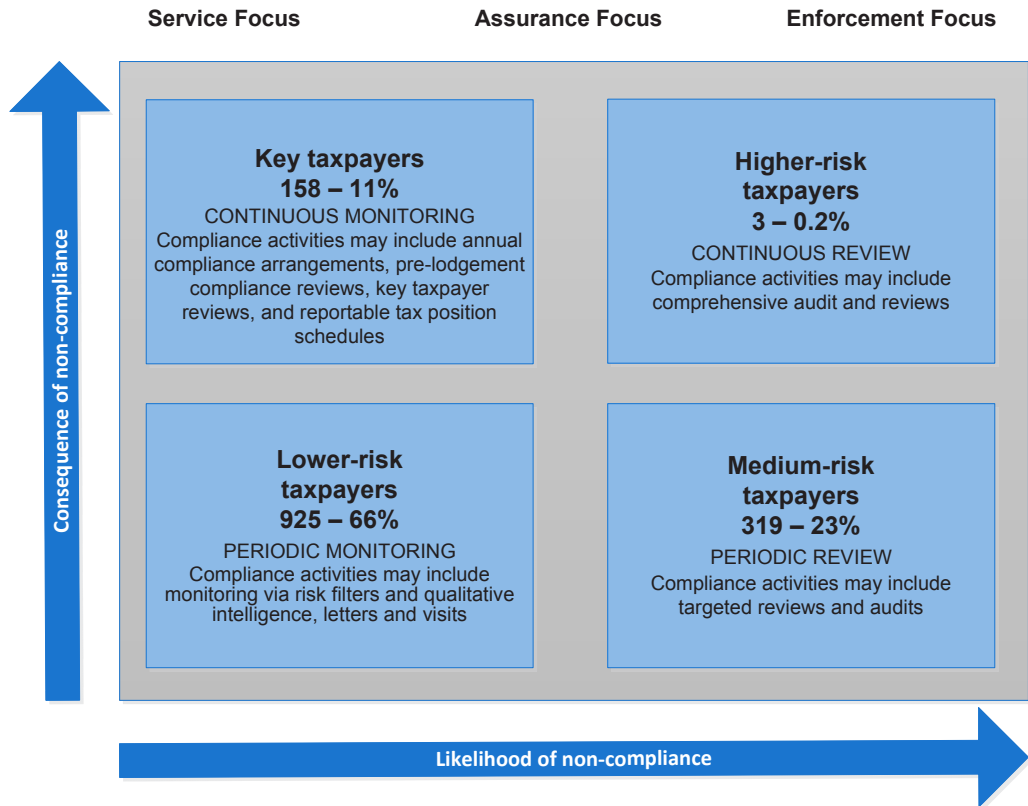
3.5 The compliance strategy for large corporate taxpayers is based on a risk-management approach that the ATO has adopted to form a view of relative taxpayer risk of non-compliance and determine the intensity of its compliance response in a coherent and considered way. The relative risk profile of the population of large corporate taxpayers is assessed primarily through the Risk Differentiation Framework (RDF), which is a risk modelling tool. In assessing risk, the RDF considers the:

- likelihood of a taxpayer's non-compliance in meeting their tax obligations; and
- consequence of non-compliance on tax revenue, given the turnover of the taxpayer, influence on other taxpayers and impact on community confidence.

3.6 Using the RDF, the ATO places large corporate taxpayers into one of four broad risk categories or quadrants, according to likelihood and consequence risk

ratings. Figure 3.1 shows the four categories in the RDF, and the number of large corporate taxpayers in each category in 2013–14.⁷⁶

Figure 3.1: Risk Differentiation Framework for large corporate taxpayers, 2013–14



Source: ANAO, based on ATO data.

3.7 Each large corporate taxpayer is assessed against the RDF for each relevant tax type (income tax, PRRT, GST and excise). The overall risk rating is the highest rating the economic group or entity is assigned for the four taxes (for example, if a business is rated as a key taxpayer for GST and medium-risk for income tax and excise, its overall rating will be as a key taxpayer).

⁷⁶ The Inspector-General of Taxation (IGoT) has examined the RDF for large corporate taxpayers in Chapter Three of the *Review into aspects of the Australian Taxation Office's use of compliance risk assessment tools*, October 2013. The IGoT made a number of recommendations to strengthen the operation, transparency and use of the RDF in the ATO's large market compliance strategy. However, the report made no substantive findings about the application of the RDF in respect of ACAs.

3.8 While the RDF has been in place since 2008, it has only been at the forefront of the ATO's large market compliance strategy since 2011 when, to improve transparency about compliance activities, taxpayers were first informed of their RDF risk profile across the three tax types. Of particular importance, is that the ATO began targeting ACAs towards key taxpayers in 2011.

Conducting the RDF process

3.9 Between July and November each year, the ATO conducts the RDF process to risk rate large corporate taxpayers. Unlike the RDF for tax segments with larger population groups, such as high wealth individuals, the RDF for large corporate taxpayers does not use highly automated processes involving algorithms and scoring systems to initially categorise taxpayers.⁷⁷ Rather it relies on largely manual processes, with most attention given to higher consequence taxpayers.

3.10 On this basis, the RDF process begins with the ATO's consideration of the consequences of a taxpayer's non-compliance. This is determined differently for each tax type. For example, for income tax consequence is generally determined by the taxpayer's turnover, and factors such as tax paid, asset value and market share are also considered.⁷⁸ As a result, the taxpayer is allocated to a higher consequence or a lower consequence classification. A higher consequence taxpayer can either be a 'key taxpayer' or a 'higher risk taxpayer' (the two highest quadrants of the RDF), depending on their likelihood of non-compliance. Similarly, lower consequence taxpayers can either be lower risk or medium risk, depending on their likelihood of non-compliance.

3.11 The ATO then assesses for higher consequence taxpayers their likelihood of non-compliance. In 2014–15 this involves using a large market profiling tool and analysing available information about these taxpayers, their

77 In applying the RDF to high wealth taxpayers, the ATO uses an extensive automated process, as discussed in ANAO Report No.35 2013–14, *Managing Compliance of High Wealth Individuals*, p. 47.

78 The ATO advised that while the initial assessment is mainly based on consequence, other factors are also considered, because it has sufficient understanding of the population of large corporate taxpayers. In considering taxpayer's consequence of non-compliance, the RDF team analyses the various consequence factors (such as market share, ability to affect the tax compliance of competitors in the industry, annual turnover, taxes paid, assets, amounts reported on activity statements, and amounts reported for excise obligations), which have been sourced from the ATO's data warehouse.

operating environment and potential tax risks.⁷⁹ Compliance staff make an informed judgement as to the initial risk rating and the relevant risk category of the taxpayer in the RDF. If the taxpayer's RDF rating changes from the previous year, he or she will be advised. Taking into account any response from the taxpayer, the compliance officer will then complete the RDF moderation report recommending a final RDF risk category for the taxpayer for the year.

3.12 For income tax (PG&I), PRRT (PG&I) and GST (ITX), an RDF Moderation Panel, comprised of Senior ATO Executives, reviews the appropriateness of the classification of each higher risk and key taxpayer.⁸⁰ This process involves reviewing each taxpayer's moderation report, as well requesting additional taxpayer assurance information when needed. The PG&I 2013–14 income tax moderation outcomes for higher consequence taxpayers resulted in a reduction in the number of taxpayers rated as 'higher risk' and 'key'. The difference between the population for 2012–13 and 2013–14 was attributed to some corporate restructuring and a number of taxpayers transitioning from higher consequence to lower consequence due to their metrics (tax payable, turnover and gross assets) falling below the thresholds applied to the higher consequence portion of the RDF model.

RDF risk classification

3.13 The number of large corporate taxpayers in each category, from 2011–12 to 2013–14, is shown in Table 3.1 and demonstrates the potential for many additional taxpayers to have entered into ACAs. For example, only 24 of 158 key taxpayers (15 per cent) had an ACA as at July 2014.⁸¹

79 The profiling tool used is a database accessed from one of the ATO's SharePoint sites that draws information from the data warehouse and case management system about the taxpayer, their taxation details and the results of any compliance activity, respectively. Officers may also manually add relevant information. Key factors considered in assessing likelihood include the taxpayer's compliance history, effective tax rate, organisational structures and governance processes.

80 In ITX, the panel considers a RDF Moderation Report covering the main likelihood and consequence data, and other qualitative information provided by client relationship managers.

81 It also shows the small number and rapid decline in large corporate taxpayers rated as higher risk, from 14 in 2011–12 to only three in 2013–14.

Table 3.1: RDF ratings of risk for large corporate taxpayers, 2011–12 to 2013–14

Classification of taxpayer risk	2011–12	2012–13	2013–14
Higher risk	14	7	3
Key taxpayers	135	163	158
Medium risk	590	321	319
Lower risk	900	1 002	925
Total	1 639	1 493	1 405

Source: ATO.

3.14 There have only been an additional seven ACAs entered into since the RDF was first used to identify key taxpayers as part of the ACA compliance strategy. Further, six of these taxpayers⁸² would not be categorised as key under the current risk assessment arrangements.⁸³

RDF classification by type of tax

3.15 The ANAO analysed the 2013–14 RDF ratings to determine the number of key taxpayers by tax type and the percentage covered by ACAs (Table 3.2). Of these taxes, income tax is the most complex and likely to be the most contentious, GST is essentially a ‘pass through’ tax, with less risk and complexity, and entities are likely to comply with excise obligations as the penalties for non-compliance include loss of licence.

Table 3.2: Number of key taxpayers by main taxes covered by ACAs

	Number of key taxpayers ¹ 2013–14	Current ACAs as at July 2014	Current ACAs as a percentage of key taxpayers
Income tax	64	12	18.8
GST	140	17	12.1
Excise	28	2	7.1

Source: ATO.

Note 1: Taxpayers are categorised under the RDF for each tax they are subject to, and some taxpayers hold an ACA for multiple taxes. Consequently, summing the number of key taxpayers or the number of ACA holders by tax type leads to double counting and to totals in excess of those reported in Table 3.1.

⁸² These include the five state government departments and one private sector company.

⁸³ These six taxpayers entered into ACAs prior to the introduction of the current risk assessment arrangements, and would now not be rated key because they are not sufficiently large in terms of the likely consequences of non-compliance.

3.16 Consistent with the greater complexity and potential benefit from real-time consideration of contentious issues, there is a higher proportion of key taxpayers with ACAs for income tax than for GST and excise. However, despite relatively fewer disputes in relation to GST (most issues relate to errors), there were more ACA holders and key taxpayers for GST than for income tax—17 (12.1 per cent) ACA holders from 140 key taxpayers for GST, compared to 12 (18.8 per cent) ACAs from 64 key taxpayers for income tax.

3.17 As discussed previously, the categorisation of 'key taxpayer' is primarily dependent on the positioning of the risk consequence axis. This is because virtually all taxpayers large enough to be positioned above the consequence axis are classified as key (only three were higher risk in 2013–14), and those below the axis are classified as medium or lower risk. In 2013–14, the PG&I moderation process (the Moderation Panel) elevated the higher consequence criteria to make allowance for the additional workload and resource requirements anticipated to flow from the increased population covered by the PG&I BSL compared to the previous LB&I BSL.⁸⁴ The number of key large corporate taxpayers for income tax consequently reduced from 87 in 2012–13 to 64 in 2013–14. The moderation process for ITX resulted in few changes in 2013–14 but the BSL advised that it is likely to also consider elevating the higher consequence criteria in the 2014–15 RDF to reduce the number of key taxpayers for GST.

3.18 There were also eight ACAs in place for FBT as at July 2014. FBT ACAs are not normally offered in isolation and are mainly incidental to ACAs as they are primarily for income tax or GST.⁸⁵ In addition, one taxpayer had entered into an ACA for PRRT as well as income tax, notwithstanding that PRRT is a complex tax that can often require rulings.

Efforts to encourage participation

3.19 On commencement in 2008, ACAs were offered to the 50 largest entities, based on the value of their annual turnover. The ATO contacted these taxpayers and made arrangements to discuss entering into an ACA. In addition to direct contact, information about the new arrangement was

⁸⁴ Chapter 1 discussed the restructure of these BSLs from July 2013.

⁸⁵ One ACA was solely for FBT. This arrangement was with an Australian Government entity that sought access to real-time advice from the ATO, as there were many circumstances where the entity was unclear about the application of FBT.

disseminated through speeches by the Commissioner and senior ATO officials at major conferences attended by large business representatives. Of these 50 taxpayers, only five had an ACA in place by 30 June 2010, of which three were previously in forward compliance arrangements (FCAs).⁸⁶

3.20 Following the initial low number of acceptances, in 2010 the ATO expanded the offer of an ACA beyond the top 50 corporate taxpayers. Different approaches were adopted by the then Large Business and International (LB&I) and Indirect Tax (ITX) BSLs, with client relationship managers visiting the top 100 corporate taxpayers by turnover and offering ACAs on a selective basis. The ITX BSL offered ACAs to taxpayers as an acknowledgment of good compliance behaviour. Concessions around penalties and interest and the extension of thresholds for correcting GST mistakes were offered in recognition of a taxpayer's good compliance. In contrast, the LB&I BSL generally targeted taxpayers to maintain their good compliance behaviour or to improve their compliance behaviour and lower their risk profile. This approach was seen as an opportunity to influence the taxpayer's compliance behaviour through more robust disclosure processes. Take up of ACAs increased throughout 2010–11, with 17 ACAs being in place by 30 June 2011 (seven administered by LB&I, 12 by ITX and six by the Small and Medium Enterprises BSL).

3.21 In 2011–12, the ATO again revised its approach to identifying those corporate taxpayers suitable for ACAs. Rather than focussing solely on turnover, the ATO also considered compliance risks, as assessed through its RDF (as previously discussed). The ATO wrote to 35 of the 135 large corporate taxpayers then rated as key, specifically inviting them to enter into an ACA. Of these, five have subsequently entered into an ACA with the ATO.

3.22 Alternatively, entities could approach the ATO requesting an ACA. While most ACAs have been initiated by the ATO (18 as indicated in Table 3.3), six were sought by taxpayers. These taxpayers entered into ACAs for different reasons including: reducing compliance costs; differentiating themselves from other taxpayers; requiring real-time certainty after being subject to increasing compliance activity by the ATO; and replicating similar relationships that overseas affiliates had with their revenue authorities. Of the

86 FCAs were similar to ACAs but the process to assess a taxpayer's governance and tax risk management was more rigorous and expensive for the taxpayer and the ATO.

18 ACAs initiated by the ATO, five taxpayers had previously held a FCA and one had a GST Cooperative Compliance Advance Agreement.⁸⁷

Table 3.3: Initiation of discussions to enter an ACA: ATO or taxpayer

	2008	2009	2010	2011	2012	2013	2014 (to July)
ATO initiated	1	2	9	1	2	2	1
Taxpayer initiated	1	0	2	1	1	1	0
Cumulative total ACAs entered into	2	4	15	17	20	23	24

Source: ANAO analysis.

3.23 Overall, the take-up of ACAs has been slow over the six years since they were introduced. While the ATO did not expect all large corporate taxpayers to enter into an ACA, only 24 of the some 100 corporate taxpayers offered an ACA have entered into one. The ATO advised it is reviewing whether six of these entities (five state government departments and one private sector entity) have sufficiently high consequences of non-compliance to warrant the costs of an ACA.⁸⁸

Promoting ACAs

3.24 Information about ACAs is publicly available on the ATO's website, and the arrangements are promoted through the ATO's engagement with various industry groups, ATO contacts, community and stakeholder forums. ACAs are also discussed in the ATO's regular publications on compliance issues such as the Large business and tax compliance booklet, Compliance in Focus, the Large business ACA process map and the ACA—what you need to know webpage.

3.25 Senior Executive Relationship Managers are offered as a contact point for the over 100 key taxpayers categorised by the RDF. These officers work collaboratively with the large corporate taxpayers to facilitate, coordinate and

87 A GST Cooperative Compliance Advance Agreement was a written agreement that formally acknowledged self-regulation and cooperation in accordance with the ATO's Cooperative Compliance Model. They were withdrawn from use on 27 January 2010.

88 The ACAs entered into with the five state government departments and one private sector entity were in respect of income tax, GST and FBT.

prioritise high level engagement across the ATO, resolve blockages and issues where other avenues have failed, and arrange access to decision makers for significant issues. As part of their visitation program⁸⁹ the relationship managers continue to promote ACAs to those taxpayers identified as potentially suitable.

3.26 The ATO also uses other communication channels to promote ACAs. For example, ATO representatives have spoken about ACAs in speeches and they are promoted in its large business bulletin.⁹⁰ Tax forums are another avenue used to inform large corporate taxpayers about ACAs. Stakeholders advised the ANAO that they had attended a number of forums where the ATO has spoken about the benefits of ACAs. The majority of ACA holders interviewed by the ANAO also confirmed that they were aware of ACAs and the key elements of the arrangements, prior to entering into their ACA. Similarly, the majority of large corporate taxpayers interviewed that had chosen not to enter into an ACA were also aware of the nature and content of ACAs.

3.27 While information about ACAs has been broadly disseminated to large corporate taxpayers, there has been no distinct strategy for determining the number or nature of large entities that the ATO would like to enter into ACAs, and what would be the most effective marketing strategy for attracting them. Developing such a strategy will require the ATO to clarify the purpose of ACAs and where these arrangements fit within the compliance framework for large corporate taxpayers. This issue is currently being considered by the ATO, as discussed later in this chapter.

ACA strategy and alignment with other compliance approaches

3.28 As discussed previously, the ATO is moving towards greater cooperative collaboration with large corporate taxpayers, with ACAs intended to promote real-time engagement. However, the ATO also has other

89 Senior Executive Relationship Managers conduct a program of regular visits with the taxpayer to discuss significant events that may have tax implications, revenue performance, risk, technical and service issues and the progress and conduct of any compliance activity.

90 ATO, *Large business bulletin*, December 2013, p. 6, available at <https://www.ato.gov.au/uploadedFiles/Content/LB_l/downloads/PGI_qc38038_nat71246_js29773.pdf> [accessed 15 July 2014]. The bulletin is a quarterly online publication aimed at large business and contains up-to-date information on income tax, GST, excise and superannuation matters with links to recent rulings, speeches and media releases.

compliance approaches with purposes similar to ACAs—in particular pre-lodgment compliance reviews for income tax and key taxpayer reviews for GST. The interaction and overlap of these approaches, together with the relatively extensive ACA processes, has led industry representatives and others to question the strategy and positioning of ACAs within the overall compliance framework for large corporate taxpayers.

3.29 ACAs are voluntary arrangements, offered to taxpayers with strong governance arrangements and a willingness to disclose contentious tax positions and risks in real time. It would therefore be reasonable to expect the administrative demands on ACA holders (and the ATO) to be lower than alternative compliance approaches. However, this is often not the case. Under current arrangements, ACA holders are required to provide written assurance confirming they have good governance and risk management processes, develop a compliance plan, disclose material risks and tax positions, participate in an annual review, and develop and implement mitigation strategies in respect of any risks that cannot be resolved at the time of the annual review. Table 3.4 outlines the other compliance approaches for large corporate taxpayers.

Table 3.4: Other compliance approaches for large corporate taxpayers

Review	Similarities and points of difference with ACAs
Pre-lodgment compliance review (PCR)	PCRs were introduced in 2011 to review tax risks for high consequence large corporate taxpayers that do not have an ACA in place. ACAs and PCRs both have a pre-lodgment, post-lodgment and risk mitigation phase, cover a two-year period and relate to disclosures made in real time towards a taxpayer's income tax return lodgment. The apparent similarities between the two approaches, coupled with how case officers are applying each are causing confusion. Six of the twelve respondents to the ANAO survey of non-ACA holders advised that the PCR met their individual needs and could see no reason to enter into an ACA.
Reportable tax position schedule (RTP)	RTPs have been piloted since 2012 and require large businesses that are not in an ACA to report material contestable positions through the lodgment of an additional schedule to the annual company tax return. The ATO will then aim to provide speedier resolution of issues, in a similar way to disclosures made under ACAs. Taxpayers lodging a RTP will not be subject to an ACA. Accordingly, there are potential benefits to taxpayers of providing a RTP, as they also do not require the formality of an ACA, but have similarly enhanced access to the ATO for resolution of contentious matters.

Review	Similarities and points of difference with ACAs
Key taxpayer review (KTR)	Introduced in September 2013 for indirect taxes in the large market, KTRs apply to those categorised as a key taxpayer under the RDF for GST and excise who do not hold an ACA. The KTR aims to provide an increased level of certainty that GST and excise tax risks are being managed effectively across an economic group. The distinction between KTRs and ACAs is not clear, as they adopt a similar approach to that of PCRs and ACAs.
Advance pricing agreement (APA) and mutual agreement procedure (MAP)	APAs and MAPs are directed towards international transactions undertaken by multinational companies. APAs allow taxpayers to reach agreement with the ATO on the future application of the arm's length principle ⁹¹ to their dealings with international related parties. MAPs are used by the ATO in dealing with foreign revenue authorities about relief from possible double tax arrangements (the same income being taxable in two jurisdictions). These arrangements are specific to international transactions and administered separately to ACAs.
External compliance assurance process (ECAP)	The ATO aims to use ECAP as part of its real-time assurance strategy as the process becomes suitable for use across elements of the RDF population. External assurers can be used for taxpayers in lower risk quadrants and for those transitioning from resource intensive assurance approaches in response to changes in behaviour. There may be implications for the design of ACAs in the pre-lodgment phase of any ECAP, although these are not apparent at this time as the ECAP pilot process only commenced in June 2014 with the evaluation report not due until February 2015.

Source: ANAO analysis.

3.30 In addition to these approaches, the ATO also conducts risk reviews and audits of large corporate taxpayers. To gain an understanding of the compliance activities applied to key taxpayers, the ANAO requested the ATO to provide the details of all compliance activities undertaken for those large corporate taxpayers categorised as key taxpayers through the RDF process in 2012–13. As shown in Table 3.5, all income tax and GST key taxpayers were subject to some compliance activity in that year, most frequently a pre-lodgement compliance review, audit or other review for income tax and

91 The arm's length principle uses the behaviour of independent parties as a guide or benchmark to determine how income and expenses are allocated in international dealings between related parties. Arm's length conditions are the conditions, including the price, gross margin, net profit, and the division of profit, that might be expected between independent entities dealing wholly independently with one another in comparable circumstances.

some form of risk review for GST. ACA holders were not subject to any compliance activity in addition to the requirements of the ACA in 2012–13.⁹²

Table 3.5: Compliance activities of 'key' large corporate taxpayers conducted in 2012–13

	Income tax	GST and excise
Total number of key taxpayers ¹	88	132
Annual compliance arrangement	8	14
Pre-lodgment compliance review	55	n/a
Reportable tax position	65	n/a
Audit	20	22
Comprehensive risk review	30	1
Other risk review ²	23	80
Key taxpayer review (GST) ³	n/a	0
Client Relationship Manager or tailored advice compliance activities	n/a	21
No compliance activity	0	0

Source: ATO.

Notes: 1 Key taxpayers can be subject to more than one compliance activity in a year.

2 Other risk review includes governance workshops, risk workshops and reviews of one or more specific risks identified.

3 Key taxpayer reviews were not introduced until 2013–14.

Future positioning of ACAs

3.31 As discussed in Chapter 2, a review by the Inspector-General of Taxation in 2012, and a number of recent ATO internal reviews, have found that the low take-up of ACAs was largely due to concerns about their prescriptive nature, high cost (particularly in the initial years) and the availability of more suitable alternative assurance approaches. Similarly, potentially suitable taxpayers advised the ANAO that the main reason for not entering into an ACA was the relatively high cost, particularly at the entry phase. They perceived other compliance activities to have similar benefits but lower administrative demands.

92 FBT was not included as the RDF is not used on the population. PRRT was not included due to the small population size.

3.32 The low take-up of ACAs has meant they have not been the centrepiece of cooperative collaboration with large corporate taxpayers as envisaged when introduced. Going forward, the ATO will have to decide whether ACAs are to continue to be positioned in this way, or rather become just a part of the spectrum of compliance approaches. Of prime importance, the ATO will need to clarify the intent of ACAs and how they can be best positioned within the compliance framework for large corporate taxpayers.

3.33 To date, the ATO has not clarified whether to target ACAs to those taxpayers whose compliance behaviours can be improved or to reward those with stronger records of disclosure and compliance. It has also not clarified how to refine ACAs over time for taxpayers demonstrating a strong record of disclosure and compliance over a number of years. In the latter scenario, ACAs could be more clearly positioned with other compliance approaches to provide a more systematic and coordinated compliance framework for large corporate taxpayers.

3.34 The ATO is currently considering the nature and positioning of ACAs in light of further emphasis on real-time compliance work as part of the 2020 vision for the ATO. Through this strategy, real-time pre-lodgment approaches are to become central for high consequence (higher risk and key taxpayers as categorised in the RDF) taxpayers, as the ATO reduces its focus on traditional post lodgment audits and reviews. ACAs are well placed to be at the forefront of such a strategy.⁹³

3.35 As indicated in Chapter 1, part of the ATO's 2020 vision is that the level of intensity of compliance activity will be tailored according to the taxpayer's placement on the Client Experience Continuum Model. In this way, the ATO will reward taxpayers' openness, transparency and willingness to participate in the tax and superannuation systems with a 'light touch' or 'no touch' experience. A large part of the move to real-time compliance arrangements are to be automated interactions between the ATO and entities, to present and resolve issues prior to the lodgment of the income tax return. While these aspirations are sound, the ANAO's recent audit of the Australian Business

93 In response to a recommendation by the Inspector-General of Taxation in the *Review into improving the self assessment system* report of August 2012, the ATO has also been examining other countries' efforts to improve cooperative compliance with large corporate taxpayers. The June 2014 internal review highlights opportunities for the ATO to learn from approaches adopted in the United States and the Netherlands (as outlined in Chapter 1). This is likely to support the refinement of the ATO's strategies for the ACA.

Register, administered partly by the ATO, found considerable scope to improve whole-of-government coordination arrangements for dealing with business.⁹⁴

3.36 Notwithstanding the intent of, and progress in implementing, the ATO's 2020 vision, there is scope for the ATO to better differentiate ACAs from other compliance activities, and better align the benefits and costs across the range of compliance activities for large corporate taxpayers.

Conclusion

3.37 While the ATO has positioned ACAs as the centrepiece of its cooperative compliance approaches, participation in the arrangement has been low. Only 24 of 158 potentially suitable key taxpayers, as categorised under the RDF, had entered into an ACA by July 2014. Further, of the 24 current ACAs, six would not be categorised as key taxpayers under the RDF if they were not already in an ACA. The ATO has not effectively leveraged off the RDF or developed a suitable marketing strategy to attract taxpayers to enter into ACAs. To improve participation, the ATO has conducted a number of reviews of the arrangement, and is considering the purpose of ACAs and where these arrangements fit within the compliance framework for large corporate taxpayers.

3.38 The main considerations for the ATO in this regard include whether to:

- limit ACAs for use as a tool for changing taxpayers' behaviour and improving their governance arrangements to address tax risks; or
- have more graduated administrative processes that are less onerous for taxpayers with a strong compliance record, which would make ACAs more attractive to taxpayers.

At the same time, the ATO needs to better differentiate alternative compliance approaches, such as pre-lodgment compliance reviews and key taxpayer reviews, to align benefits and costs across the range of compliance approaches for large corporate taxpayers. Refining the overall compliance strategy for large corporate taxpayers, in line with its 2020 vision, would better position the ATO to actively market ACAs, to attract the appropriate number and type of taxpayers.

94 ANAO, Audit Report No.48 2013–14 *Administration of the Australian Business Register*, pp. 17–18.

Recommendation No.1

3.39 To better tailor ACAs to taxpayers' assessed compliance risks, the ANAO recommends that the ATO reassesses: the design of these arrangements within the compliance framework for large corporate taxpayers; the level of compliance assurance required to provide benefits for both parties; and the administrative processes.

ATO response: *Agreed.*

3.40 *The ATO is committed to improving the ACA product and reducing both compliance costs for taxpayers and administrative costs for the ATO.*

4. Administration of Annual Compliance Arrangements

This chapter examines the ATO’s administration of ACAs.

Introduction

4.1 The ATO has developed a three-phase process for the administration of ACAs, which is outlined in the *Large Business Annual Compliance Arrangements* process map (ACA process map).⁹⁵ The process map (outlined in Table 4.1) sets out the high-level tasks and activities for the administration of the three phases of all ACAs, irrespective of tax type or business and service line (BSL).

Table 4.1: Key processes for administering ACAs

Entry	Throughout the year	Annual review
<p>The option to develop a memorandum of understanding between the parties to clarify expectations, processes and timelines for the ACA.</p> <p>ACA taxpayers provide a letter from the Chief Executive Officer or Chief Finance Officer on behalf of the Board confirming good corporate governance processes. Alternatively, the ATO reviews the taxpayer’s governance arrangements.</p> <p>Develop a terms of arrangement document that sets out how the ACA works in practice.</p>	<p>ACA taxpayers to openly discuss material risks and tax positions that they are uncertain about.</p> <p>The ATO will review tax risk disclosures made by the taxpayer.</p> <p>The ATO will allocate a senior officer to manage the relationship during the ACA.</p>	<p>At the end of the financial year, the ATO and the taxpayer will jointly review the taxpayer’s tax return.</p> <p>The ATO will provide the taxpayer with sign-off on low tax risks and develop mitigation strategies for others.</p>

Source: ATO.

4.2 To assess the administration of ACAs, the ANAO analysed the electronic case management files for those 24 ACAs current at the time of this audit (July 2014), to determine whether the key processes for administering ACAs had been completed and appropriately documented for each of the three

95 ATO, available from <<https://www.ato.gov.au/Business/Large-business/In-detail/Compliance-and-governance/Annual-Compliance-Arrangements/>> [accessed 7 June 2014].

phases: entry; throughout the year; and the annual review. The ANAO also held discussions with all current and previous ACA holders and ATO officers involved in the administration of 30 of the 40 tax schedules associated with the 24 ACAs.⁹⁶

Entering into an ACA

4.3 As discussed previously, ACAs are targeted at those taxpayers categorised by the RDF as key taxpayers. While the taxpayer's overall RDF rating is the starting point for assessing suitability for an ACA, the entry process involves the three processes outlined in Table 4.1.

Developing a memorandum of understanding

4.4 A memorandum of understanding (MoU) may be entered between the taxpayer and the ATO to gain in principle agreement to develop and implement the ACA in the context of each party's roles and responsibilities. Entering into a MoU is optional, however, ATO guidance states that a MoU may strengthen the collaboration between the taxpayer and the ATO.

4.5 The MoU is normally a short document and is prepared once the taxpayer and ATO have agreed in principle to enter into an ACA. This is before the development of the ACA terms of arrangement. In some cases, for example where the taxpayer and the ATO are already working together in an open and transparent way, a MoU is not necessary. Some taxpayers, however, prefer to sign a MoU as it demonstrates an overt commitment to working in an open and transparent way. The ATO advised that a number of corporate tax managers considered that the MoU helped them to gain commitment to the ACA from within their own organisations.

4.6 Since the introduction of ACAs, seven MoUs have been entered into by the ATO and taxpayers. The seven most recent ACAs have not included a MoU, indicating a move away from this step in the process as familiarity with these arrangements increases across the large taxpayer market.

96 An ACA has a schedule for each tax that is covered by the ACA. A multi-tax ACA will, for example, have four tax schedules if there are four taxes covered by the ACA.

Providing a governance letter

4.7 ATO guidance states that a letter from the taxpayer's Chief Executive Officer or Chief Financial Officer is a key document in the establishment of the ACA. The purpose of this letter is to confirm that the entity:

- has sound governance processes supporting tax compliance⁹⁷; and
- is willing to work collaboratively with the ATO to manage tax risks, including through disclosure of all uncertain and material tax matters.

4.8 Of the 24 taxpayers with ACAs in place at July 2014, five previously had FCAs⁹⁸ and one had a GST Cooperative Compliance Advance Agreement with the ATO. These taxpayers were not required to provide a governance letter because they had been subject to governance reviews. Of the remaining 18 ACAs, examination of the case files indicated that 10 taxpayers had provided governance letters prior to entering into an ACA with the ATO. The ATO validated these letters for the 10 taxpayers in a variety of ways, including:

- having discussions or informal workshops with taxpayers about the ATO's governance requirements for an ACA (four taxpayers, covering income tax, GST, excise and FBT);
- using the taxpayer's own review of their governance and tax risk management practices (three taxpayers, covering income tax and GST); and
- using the knowledge gained from recent compliance activities (three taxpayers, covering GST, income tax and PRRT).

For the other eight taxpayers (all in relation to ACAs for GST), the ATO conducted a formal extensive governance assurance review which broadly

97 Guidance on good tax governance is provided in Chapter 3 of the ATO's *Large business and tax compliance* publication, available from https://www.ato.gov.au/uploadedFiles/Content/LB_1/downloads/BUS16985lrgbustaxcomp.pdf [accessed 8 July 2014].

98 The ATO advised that, under FCAs, introduced in 2006, the process to assess a taxpayer's tax governance arrangements was more rigorous than the current process for ACAs, with each taxpayer required to have their governance and tax risk management practices reviewed by the ATO as part of entering the FCA. Feedback from taxpayers was that this process was too costly and FCAs were modified to become ACAs. The trade-off was that taxpayers would receive a reduced level of certainty but at a lower cost.

involved assessing a taxpayer's strategic and operational risk management and record keeping practices.⁹⁹

4.9 Conducting governance reviews is part of the compliance program for the large market in the Indirect Tax (ITX) BSL. In one instance, a taxpayer elected to have a governance review as part of establishing the ACA rather than providing the governance letter. These reviews aim to provide the ATO with reasonable assurance that the taxpayer has in place effective systems and processes that result in optimum voluntary compliance.¹⁰⁰ As part of this review, the ATO will assess the effectiveness of the taxpayer's governance frameworks.¹⁰¹ The ATO views a request by the taxpayer to have their governance reviewed as a demonstration of the taxpayer's transparency and willingness to work with the ATO, and also assists the ATO and the taxpayer to assess the appropriateness of entering into an ACA in a more timely manner.

4.10 The ATO advised that governance reviews form a part of the compliance program for ITX because GST is a transaction based tax and GST compliance is more reliant on effective systems. Compliance issues relating to income tax and FBT are more commonly the result of interpretation, that is, the taxpayer and the ATO interpreting the law differently. As discussed later, ongoing assessment of a taxpayer's governance is an element of an ACA covering GST, whereas the ATO relies on an annual letter from the taxpayer that they have sound governance and tax risk management practices in relation to ACAs for income tax and FBT.

4.11 Nonetheless, undertaking these governance assurance reviews may add to the perception of taxpayers that the costs of an ACA, particularly the entry costs, outweigh the benefits. As discussed in Chapter 2, a majority of taxpayers that had not entered into an ACA considered the start-up costs were a barrier to entering into an ACA. However, the ATO advised that governance

99 'Chapter 3 Good Tax Governance', *Large business and tax compliance* publication, https://www.ato.gov.au/uploadedFiles/Content/LB_I/downloads/BUS16985lrgbustaxcomp.pdf [accessed 11 September 2014].

100 To achieve this, the ATO may review: the taxpayer's entity level governance and risk management framework; the taxpayer's history of voluntary compliance, including requests for private rulings and voluntary disclosures; previous compliance activity findings conducted by the ATO; financial management, processing and reporting systems; and any specific GST risks and issues of concern to either the taxpayer or the ATO.

101 Documents reviewed may include the taxpayer's: risk matrix; management representation letters; internal audit plan; tax governance framework; and integrated risk management plan.

reviews form a part of their compliance program and are tailored to reflect the level of understanding and confidence the ATO has of the taxpayer's governance and tax risk management processes. Notwithstanding this, there would be merit in the ATO examining the basis for conducting governance reviews, rather than accepting assurance letters, and adopting a more consistent approach across ACAs.

Developing the terms of arrangement

4.12 The ACA terms of arrangement (ToA) establishes the general operating and relationship conditions for the ACA, including the expectations and obligations of both parties. The ToA are administrative and not legally binding. They consist of a head agreement outlining the general conditions of the arrangement and a schedule for each tax covered by the ACA.¹⁰² Although the ToA are intended to be flexible and tailored to each taxpayer, the ATO has developed a generic ToA document that forms the basis of ACA negotiations and includes 21 clauses in the head agreement. As at July 2014, the 24 ACAs included 24 head agreements and 40 tax schedules.

4.13 The ANAO reviewed these 24 ToAs against the 21 clauses of the generic ToA.¹⁰³ This analysis revealed greater variability than expected across taxpayers. In particular, key elements of the process are not consistent across all taxpayers in relation to how:

- a taxpayer's governance and tax risk management is assessed. Eighteen ACA holders are required to provide an annual letter confirming that they have sound governance and tax risk management practices. The remaining six taxpayers had other provisions included in their ToAs: one taxpayer was only required to provide the letter at the beginning of the arrangement; two taxpayers had the option of providing the letter or having additional work undertaken as part of the annual review; and three taxpayers had their governance assessed at the commencement of the ACA and then as part of each annual review;

102 The ToA schedules outline tax specific terms such as the tax return review process and the treatment of penalties and interest.

103 The ANAO has combined some clauses into one for the purpose of analysis. For example the 'renewal and operational term' and 'extension and amendment of the ACA' clauses have been combined into 'duration'.

- often the steering committees and working groups meet.¹⁰⁴ Nineteen of the ToAs required that the steering committee meet at least annually; one required at least semi-annual meetings; and the remaining four indicated that the steering committees may be convened at any time or as necessary. In relation to how frequently the working groups are required to meet: 21 ToAs did not specify a frequency; one stated that meetings are to occur at a minimum annually, two months before the annual steering committee meeting; one stated one month before the annual steering committee meeting; and one stated that meetings should occur at least once per quarter; and
- annual sign-off is provided. In 20 ToAs, the ATO has agreed to provide the taxpayer with a sign-off letter each year. The sign-off letter will effectively close off the ATO's review or audit activity in respect of the tax return in relation to the effect of legislation enacted at the date of such letter.¹⁰⁵ The remaining four ToAs make no reference to sign-off letters.

4.14 PG&I BSL's 2012 *Review of Annual Compliance Arrangements* made six recommendations in relation to strengthening the development of ACAs, including that:

- consideration be given to developing generic ACAs for certain industries to ensure consistent treatment of taxpayers in the same industry;
- terms in the ToA that are proposed to be removed and/or altered, or the addition of new terms, should be negotiated by a senior officer and communicated to the ACA Oversight Committee; and
- further clarification of those terms of the generic ToA that should not be removed and/or altered.

4.15 As at July 2014, no implementation plan had been developed in response to the 2012 review. However, the ATO advised the ANAO that the ACA Oversight Committee now takes a more proactive role in providing

104 The steering committee involves representatives from the ATO and the taxpayer. It provides governance oversight for the operation of the ACA and has ultimate responsibility for the operation of the ACA. Working groups are established for each active tax schedule covered by the ACA to provide support to the steering committee.

105 The exception to this is that issues listed in the letter itself as unresolved are not covered. In addition, the sign-off is subject to the taxpayer disclosing all relevant information and evidence of fraud or evasion not becoming apparent. The letter also does not restrict the ATO's administration of legislation enacted after the date of the letter.

advice on clauses that cannot be tailored or changed. This was evident in minutes from the ACA Oversight Committee. For example, the Committee has discussed the clauses relating to: practical certainty; materiality in relation to disclosures; full and true disclosure; and sign-off.

4.16 While some variability in the terms is to be expected given that these are individual arrangements with taxpayers, there would be benefit in the ATO continuing to closely monitor differences across ACAs. At present, all ACA ToAs are referred to the ACA Oversight Committee for consideration and comment, with a particular focus on variations from the standard terms.

Penalty and interest concessions and correcting mistakes

4.17 In the event of a tax shortfall, ACA holders receive concessionary treatment of penalties and interest in certain circumstances. Penalties are either not imposed or imposed relevant to the behaviour. There are three possible interest outcomes: full remission of interest; remission of interest to a concessionary rate; and no remission of interest. In addition, taxpayers who have included GST and excise in their ACAs also receive extended correcting thresholds (relating to value and time) for errors. Consequently, ACA holders can correct errors made in the preceding tax period in the GST/excise return for the current period.

4.18 The ANAO reviewed the concessions and correcting thresholds provided to all ACA taxpayers for each of the tax types. The ANAO's analysis relating to penalties and interest concessions and extended correcting thresholds is presented in Table 4.2.

Table 4.2: Penalty and interest concessions and extended correcting thresholds

Tax	Observation
Penalty and interest concessions	
GST	<p>Thirteen ACAs stated that if the reason for a GST shortfall is an interpretational decision and the revenue outcome is neutral, interest is remitted in full. If the revenue outcome is not neutral, interest is remitted at the concessional rate. The remaining four taxpayers did not have this included in their ACAs.</p> <p>Of the 17 taxpayers with an ACA covering GST, 15 had a concessionary rate of interest of the base rate as defined in section 8AAD of the <i>Taxation Administration Act 1953</i> less one per cent. For the remaining two taxpayers, they received a greater concession: the base rate less two per cent.</p>
Excise	There was no variability in the treatment of penalties and interest for the two ACAs covering excise.

Tax	Observation
Income tax	All 12 income tax ACA taxpayers received a concessionary interest rate of the base rate less one per cent. For one taxpayer whose ACA covered GST and income tax, the GST concessionary interest rate was different to the income tax concessionary rate, two per cent and one per cent respectively.
FBT	Of the eight ACAs that cover FBT, six had a concessionary rate of interest of the base rate as defined in section 8AAD of the <i>Taxation Administration Act 1953</i> less one per cent. For the remaining two taxpayers, they received a greater concession: the base rate less two per cent.
Extended correcting thresholds	
GST	Most GST ACA taxpayers (14 of 17) had their time and value correction limits extended to 12 months and \$1 million respectively. This is an increase from three months and \$300 000. One taxpayer had its limit increased to 36 months and \$3 million and two taxpayers had their limits increased to 48 months and \$5 million. A further taxpayer had an extension of \$4 million and 12 months or \$1 million if the correction was made between 12 and 48 months.
Excise	One taxpayer had the correcting thresholds extended to 12 months and \$1 million for excise while the other taxpayer with an ACA covering excise had the correcting thresholds extended to 48 months and \$5 million.

Source: ANAO analysis of ACAs.

4.19 As outlined in Table 4.2, four taxpayers have more generous penalty and interest concessions and correcting thresholds. The ATO's rationale for these differences is that three of these taxpayers went through a more extensive governance review process. The remaining taxpayer was an early entrant into an ACA. In regard to these taxpayers, the ACA Oversight Committee has indicated that it will encourage ATO officers to advise these taxpayers that over time the ATO will seek to align those concessions with the majority of ACA holders.

4.20 These observations were generally consistent with those of the ATO's 2012 *Review of Annual Compliance Arrangements*. The ATO found at that time that there were variations in the level of concessions offered between income tax ACAs but also between the different tax types covered by an ACA. The review noted that there was a need for a consistent ATO position on penalty and interest concessions. In November 2013, the issue of penalty and interest concessions was considered by the ACA Oversight Committee. The Committee agreed to adopt a consistent set of principles in relation to concessions, and that these would apply on a prospective basis. The one ACA signed since this time is consistent with these principles.

4.21 The ATO review also questioned the penalty concessionary benefits relating to income tax ACAs, stating that in circumstances where a shortfall

has arisen but: the taxpayer has taken reasonable care; the taxpayer has a reasonably arguable position; and no anti-avoidance provision applies, it is difficult to see how a tax shortfall penalty would apply to any taxpayer, even a non-ACA taxpayer.

4.22 The benefits relating to penalty and interest concessions are apparent in all ACAs and the benefits relating to correcting GST and excise errors are included in all GST and excise ACAs. As outlined above, there is some variability across taxpayers, potentially meaning that some taxpayers receive greater benefit from their ACA than other taxpayers.

4.23 The ATO advised that it does not regularly measure the impact on revenue of the penalty and interest concessions for ACA holders because it is a complex, manual process that is very time consuming. As such, the ATO is unable to identify the monetary benefits (if any) that are provided to taxpayers through ACAs. However, in one instance, the ATO has measured the benefit a taxpayer received from the concessionary rate of interest. The ATO found that for GST this particular taxpayer received an additional \$284 280 reduction in their interest charge over a six-year period (\$47 380 on average per year) than would have been the case if they did not have an ACA. The ATO considered this to be relatively immaterial given the value of tax paid by this taxpayer was in the order of \$6.5 billion. Notwithstanding the ATO's view that the cost of concessions has been immaterial to date, access to concessions is a key benefit for ACA holders, and should be quantified as part of the evaluation of the effectiveness of ACAs, discussed in Chapter 2.

Treatment of legacy issues

4.24 Legacy issues are taxation issues that are outstanding at the time an ACA is entered into. They include, for example, issues under an existing comprehensive risk review or audit. They are outstanding because there is no certainty over the tax treatment of the particular issue at that particular time.¹⁰⁶ Most taxpayers (15 of 24) had at least one legacy issue at the time of entering into an ACA.

4.25 Some ATO officers commented during discussions with the ANAO that dealing with legacy issues had caused problems for the administration of the ACA and that it may be better to resolve these issues before entering into an

¹⁰⁶ As discussed in Chapter 2, an example of a legacy issue is the implications for GST of multi-party transactions, where it is not obvious who makes a supply, of what, to whom, or at what price.

ACA. In particular, the ATO advised there were two instances where disagreement between the ATO and the taxpayer about whether legacy issues were covered by the ACA had caused uncertainty about the annual sign-off. The ATO advised this had led to tensions between the ATO and ACA holder. ACA holders also noted that resolving legacy issues before entering into an ACA assisted in avoiding a strained relationship between the parties.

4.26 The ATO's 2012 *Review of Annual Compliance Arrangements* noted that it is important to clearly define and articulate legacy issues. The review found that it was important for compliance teams to obtain sufficient information at the time of entering into an ACA for such issues to be considered a disclosure under an ACA.

4.27 As at May 2014, the ATO had not developed any written guidance as to the treatment or transition of legacy issues into an ACA. There was also no specific section on legacy issues in the generic ToA document or the ToAs that had been signed with taxpayers. Enhancing guidance about legacy issues would support the consistent administration of ACAs and provide greater clarity to taxpayers considering entering into an ACA. The extent of legacy issues affecting ACAs also highlights the importance of the ATO reaching decisions on contentious issues in a timely way through its rulings processes.¹⁰⁷

Administering ACAs throughout the year

4.28 ACAs aim to improve practical certainty for taxpayers by considering tax risks in real time. As a consequence, the ATO and the taxpayer have ongoing contact throughout the year. The nature of this contact is summarised in Table 4.3.

¹⁰⁷ The rulings process refers to the advice developed by the ATO setting out their interpretation of the laws administered by the Commissioner of Taxation. This advice is binding on the ATO.

Table 4.3: Administration throughout the year—ATO and taxpayer roles

ATO	Taxpayer
<p>Keep the taxpayer informed of developments that could materially impact on their tax obligations.</p> <p>Allocate a senior officer to manage the relationship during the ACA.</p> <p>Jointly review risk disclosures made by the taxpayer.</p> <p>Consider the effectiveness of the taxpayer's operational controls and tax risk management processes.</p> <p>Contact the taxpayer about potential tax risks, for example to ask about variations in tax payments and discuss media reports.</p> <p>Expedite the taxpayer's enquiries and requests for advice.</p>	<p>Inform the ATO of material risks and tax positions that are uncertain, including those under consideration.</p> <p>Openly discuss material tax risks with the ATO and ensure there is sufficient and timely information to make joint risk assessments.</p> <p>Disclose any other material risks or matters, for example developments that: may have a reputation impact; affect tax payments; or change tax risk governance functions or key staffing arrangements.</p> <p>Request private binding rulings as necessary.</p>

Source: ATO ACA process map.

4.29 For the 19 ACAs where at least one year of review had been completed¹⁰⁸, the ANAO reviewed the following key elements:

- how the ATO considered the effectiveness of the taxpayer's operational controls and tax risk management throughout the year;
- how disclosures and issues were managed; and
- the relationship and governance arrangements for individual ACAs.

Annual assessment of the effectiveness of the taxpayer's operational controls and tax risk management

4.30 Having sound tax risk management processes in place is one of two concepts around which the ACA is built.¹⁰⁹ While tax risk management is assessed before entering into an ACA, the expectation is that the ATO and taxpayers will verify tax risk management on an annual basis.

4.31 In relation to the 19 ACAs assessed by the ANAO, 13 stated in their ToAs that the taxpayer is required to provide the ATO with a letter confirming

¹⁰⁸ For five ACAs, the ATO's case management system indicated that the review for year one was still in progress.

¹⁰⁹ ATO, *Annual Compliance Arrangements —what you need to know*, available from <<https://www.ato.gov.au/Business/Large-business/In-detail/Compliance-and-governance/Annual-Compliance-Arrangements/>> [accessed 11 June 2014].

that they have sound governance and tax risk management on an annual basis. A further five taxpayers are not required to provide the governance letter, instead having governance assessed as part of the annual review. As discussed in paragraph 4.13, the remaining taxpayer was only required to provide the letter at the beginning of the arrangement. There was also no documentation on the ATO's case management system in relation to the annual assessment of this taxpayer's governance and tax risk management.

4.32 For the 13 taxpayers required to provide an annual governance letter, in two cases there was no evidence on the ATO's case management system that this had been provided. For a further three cases there was only evidence that this letter had been provided for some of the years: two years of the five years reviewed for the first taxpayer; one year of six years reviewed for the second taxpayer; and one year of five years reviewed for the third taxpayer. There was also no documentation to indicate that the matter had been followed up by the ATO.

4.33 For those five taxpayers (all GST ACA holders) where governance is assessed on an annual basis, this process involved updating the ATO on significant changes to the risk management framework, policies and standards and providing the ATO with copies of relevant documentation about these changes. Taxpayers are also required to provide information on major system changes, upgrades and the integration of systems which will impact on the integrity of tax data. There was evidence on the ATO's electronic case management system that the five taxpayers had their governance and tax risk management practices assessed as part of the annual review process.

4.34 Given the variation across taxpayers as to how operational controls and tax risk management is assessed on an annual basis, there would be benefit in the ATO clarifying the rationale for some taxpayers having more onerous annual assessments than others, especially given the feedback from taxpayers that the ACA process is considered to be costly.

Management of disclosures and issues

4.35 The second concept that ACAs are built around is a commitment to ongoing disclosure of tax risk, and the ToA establishes the guidelines for disclosures of tax issues throughout the year. Analysis of the 24 ToAs revealed that the disclosure guidelines were relatively consistent across ACAs. Generally, taxpayers must disclose details of existing, emerging and new material tax risks as soon as practicable. To be characterised as a tax risk, it

must be in relation to a transaction: seriously contemplated; entered into; or to be undertaken. The relevant tax schedule lists items of material tax risk that the taxpayer must disclose to the Commissioner. If in doubt about whether to disclose a material tax risk, in the spirit of the ACA the risk should be disclosed. If the taxpayer is in doubt about whether a disclosure is material, they should discuss the matter with the ATO.

4.36 The ATO advised that individual teams managing ACAs have flexibility in how they record information in relation to disclosures throughout the year. While flexibility may allow teams to tailor their record keeping practices to the individual taxpayer's circumstances, this also presents a risk to the accuracy and completeness of information collected.

4.37 The ANAO reviewed the case management files and found a variety of approaches to recording and managing disclosures and issues. There was evidence on the case management system for only five of the ACA taxpayers that the ATO had kept details of disclosures and issues in a spreadsheet. This included information about: the disclosure or issue; the value of the risk; case management reference numbers; relevant dates; status; and outcomes. For two taxpayers, ATO officers had developed communication logs and stored them on the case management system. This included details about the communication, including whether it was a disclosure. Overall, the ANAO was not able to readily determine from the case management system files the content and number of disclosures made by ACA holders throughout the year.

4.38 The ANAO requested that the ATO provide the number of disclosures made by each taxpayer over the past three years. The PG&I BSL's reporting shows that in 2013–14, the 12 taxpayers at the time with an ACA covering income tax made a total of 41 disclosures (three disclosures on average per taxpayer) to the ATO. These 41 disclosures involved transactions valued at approximately \$13.7 billion. However, the ATO was not able to validate the accuracy of this information that indicated that: 29 of the disclosures were made by four taxpayers; one taxpayer made three disclosures; three taxpayers made two disclosures; three taxpayers made one disclosure each; and one taxpayer made no disclosures over this period. The ATO officer who compiles this report advised the ANAO that it is based on information received from the ATO teams working on the ACAs and that there could be some confusion about what is meant by disclosure. For example, an issue that is disclosed by a taxpayer but resolved relatively easily by the ATO may not be counted as a

disclosure. The ANAO was also not able to verify this information during the analysis of the ATO's electronic case management system files.

4.39 For GST and excise, the 17 taxpayers with ACAs covering GST and/or excise in 2013–14 made 53 disclosures (an average of approximately three disclosures per taxpayer). The ATO extracted this information through a manual process. ATO officers involved in the administration of the ACAs reviewed the taxpayers' case management files and identified records such as voluntary disclosures of tax shortfalls, ruling requests or issues recorded in the maintenance review case (discussed later). This figure does not include the ACA taxpayer disclosures that may have been made outside the maintenance review case and recorded as a client interaction on the case management system.

4.40 Similarly, for disclosures made by FBT taxpayers in an ACA, the ATO has not drawn this information together in a consistent and systematic way. Instead, to extract this information involved a manual process of searching through a taxpayer's files. The ATO advised that the eight FBT taxpayers made two disclosures in 2013–14.

4.41 When disclosures are made by ACA taxpayers, the ATO's process is to risk assess each disclosure and develop mitigation strategies for those disclosures perceived as high risk. The ATO provided examples to demonstrate the risk assessment of disclosures. These examples show that a variety of approaches are adopted depending on the nature of the disclosure. For disclosures which are relatively immaterial and/or low risk, ATO records show that the disclosure is considered and a record of the risk assessment may be made, for example in an email. For disclosures that are material, a more formal process is adopted. This includes developing assessment reports which outline the disclosure and significance and mitigation strategies, which may include further formal compliance activities such as comprehensive risk reviews and audits. Mitigation strategies are discussed further at paragraph 4.57.

Recommendation No.2

4.42 To support ongoing assessment of the effectiveness of ACAs to identify and mitigate tax risks in real time, the ANAO recommends that the ATO enhance its record keeping of taxpayers' disclosures of contentious tax positions, and the strategies developed to deal with these disclosures.

ATO response: *Agreed.*

4.43 *The ATO recognises the need to ensure transparency of its processes through improved record keeping, as well as maximising the benefits of the ACA program through more sophisticated use of the information collected.*

4.44 Monitoring disclosures and the effectiveness of the mitigation strategies to address these risks will help to highlight any similarities and differences between BSLs in the extent and nature of disclosures, which would also help the ATO to better tailor ACAs to the different taxes covered.

4.45 Consistent with the ANAO's findings, the ATO's 2012 *Review of Annual Compliance Arrangements* also identified that, although there was relative consistency in the wording of disclosure clauses, there have been inconsistent levels of disclosure from taxpayers under an ACA. This inconsistency related to the timing and nature of disclosures and the concept of materiality. In response to this finding, the ATO has modified the wording of the ToA to help clarify the conditions surrounding disclosures and reviewed the guidance provided to ATO officers in relation to disclosures.

Relationship and governance arrangements

4.46 The governance arrangements for an individual ACA involve ACA communication representatives, a steering committee and a working group. The communication representatives are the primary points of contact for each party for matters relevant to more than one tax. The steering committee involves representatives from the ATO and the taxpayer. It is established to provide governance oversight of the operation of the ACA and it has ultimate responsibility for the operation of the ACA. The seniority of members of this committee varies across ACAs. Most ACAs do not specify the membership of the steering committee, instead stating that the members should have the necessary authority, seniority and level of independence from ACA working groups to enable appropriate oversight of the operation of the ACA. Others had nominated specific positions as being on the steering committee.¹¹⁰

4.47 In addition to a steering committee, a working group is established for each active tax schedule to provide support to the steering committee. Membership of the working group(s) is determined at the discretion of the

¹¹⁰ Four ACAs required Assistant Commissioners to be on the steering committee, one required a National Director and the ACA representatives to be on the steering committee, one required two Deputy Commissioners and one required three Senior Executive Service members to be on the steering committee, including the Second Commissioner.

parties and usually includes members from the ATO's compliance team and senior officers from the taxpayer's tax area.

4.48 In terms of managing multi-tax ACAs that cross BSLs, four taxpayers advised that they would prefer to see a more unified approach from the ATO. One ATO officer responsible for 11 GST ACAs (of which five include cross BSL ACAs) also advised that there is scope to work more closely across BSLs where there are multiple taxes included in the ACA that are administered in separate BSLs. This was also part of the rationale for establishing the ACA Oversight Committee in June 2012.

4.49 The ATO's 2012 *Review of Annual Compliance Arrangements* also found that there was scope to improve the real-time engagement approach where ACAs were being managed across BSLs. The review stated that real-time engagement should occur as 'one' ATO and not replicated for each arrangement. The review noted that:

although client teams are monitoring the media and Australian Securities Exchange announcements to varying degrees, and irrespective of other ACAs, the LB&I [now PG&I] team should liaise with their Indirect Tax business line colleagues to be briefed on any movements or irregularities in the monthly Business Activity Statements lodged. Any irregularities could instigate a proactive real time discussion with the client and may elicit disclosures that may not have otherwise been initiated by the taxpayer at that time. It would further demonstrate to the taxpayer that we [the ATO] have a real time engagement with them.

4.50 In this light, there would be merit in the ATO continuing to enhance the role of the ACA Oversight Committee in coordinating ACAs across BSLs. The ATO could also identify better ways of working more closely across BSLs at the individual team level. This might include formalising meetings between ATO compliance officers that are not in the same BSL or enhanced information sharing arrangements regarding ACA holders. Currently meetings between ATO compliance officers in different BSLs only occur on an ad hoc basis and information sharing across BSLs occurs predominantly at the ACA Oversight Committee or the steering committees rather than at the compliance team level.

Annual ACA review

4.51 The purpose of the annual review is to review the taxpayer's tax risks and transactions for the year so that the year can be signed off or mitigation strategies can be developed for any high risk issues. ATO guidance provides

information about what each party (the ATO and taxpayer) is expected to do during this process, as outlined in Table 4.4.

Table 4.4: Annual review—ATO and taxpayer roles

ATO	Taxpayer
<p>The ATO will arrange an annual review meeting with the taxpayer to:</p> <ul style="list-style-type: none"> • review major transactions and business events during the year; • review the taxpayer's: statutory accounts, book to tax reconciliation, annual income tax return, business activity statements and any other relevant factors to identify risks; and • openly discuss with the taxpayer any identified risks. For any risks that require further action, the ATO and the taxpayer will agree on the mitigation steps and when these will take place. 	<p>Taxpayers participate with the ATO in the annual review meeting to:</p> <ul style="list-style-type: none"> • advise of any further material risks that were identified, for example in preparing the tax return; • advise of any changes to transactions or tax positions for any risks already assessed; • work with the ATO to develop and implement mitigation strategies in respect of any risks that cannot be resolved at the time of the annual review; and • inform the ATO of any material changes including emerging risks, inadvertent errors and changes that may have a material impact on risks or tax liability.

Source: ACA process map.

4.52 Subsequent to the taxpayer lodging their tax return, the ACA working group(s) meet to discuss and review the tax return.¹¹¹ Minutes of these meetings are required to be recorded and attached to the taxpayer's case management file. For 14 taxpayers there was evidence that working group meetings had taken place.¹¹² Where meetings had not taken place (five taxpayers), issues had been discussed via email. At the working group meetings and through correspondence, the parties discussed the material issues affecting the taxpayer's tax return. These issues included: the tax treatment of government conditional grants; overpaid dividends; transfer pricing; international related-party loans; and research and development tax offsets. Taxpayers provided information about these issues and the ATO requested additional information where relevant.

111 Most ToAs (21 of 24) do not require the working group to meet annually. However, the ANAO review of case files suggests that most working groups meet at least annually.

112 As discussed in the previous section, the ANAO's analysis covered 19 of the 24 ACA taxpayers as the first year of review was still in progress for five taxpayers.

4.53 After the working group meeting, a report summarising the annual review is completed.¹¹³ The ATO has not specified the form of this report and has not provided guidance to staff on information that should be included. Since 2008, there have been 74 annual reviews finalised relating to the 19 ACAs (32 tax schedules) where at least one year of review has been finalised. Of these, 66 annual review reports had been completed. The remaining eight reports had either not been completed or could not be located by the ATO.

4.54 Not surprisingly, there was some variability across teams and BSLs as to what was included in the annual review reports. The ANAO assessed in detail 24 reports for 16 ACA holders for the 2013 review year.¹¹⁴ All 24 of these reports examined tax risks. The main differences across tax types were that:

- three income tax review reports included additional information about: interactions with the taxpayer; other ATO activity, including other compliance activity and private binding rulings; and other verification work undertaken on the taxpayer's tax risk and governance processes;
- fourteen GST/excise review reports included assessments of the general governance and tax risk management practices of taxpayers. These reviews noted that they were limited to a high level and reliant on information provided by the taxpayer; and
- seven FBT review reports also considered the general governance and tax risk management practices of ACA holders, however, to a lesser extent than for GST/excise ACA holders.

4.55 The review report is submitted to the steering committee for endorsement, although two taxpayers advised that steering committees only meet if there are disputes between the ATO and the taxpayer.¹¹⁵ Following the steering committee's review and endorsement of the working group's recommendations, the ATO advises the taxpayer of the outcome for the review year by letter. This letter includes an ATO view on the continuation of the ACA arrangement for the next 12 months (no ACAs have been exited) and,

113 The purpose of this report, prepared by the working group, is to provide the steering committee with information about each risk and to provide recommendations about how each risk or issue should be rated.

114 Reports for two ACA taxpayers were not completed and the report for one taxpayer could not be located.

115 The steering committee may include some members of the working group, but also a more senior officer. In one instance the membership of the working group and the steering committee was the same, which meant that in practical terms the steering committee was approving its own work.

where it has been agreed in the ToA, the ATO also provides sign-off on low tax risks or advises of risks which require further action.

4.56 It was not possible to determine from the documentation on the ATO's case management system the number of tax risks that were considered as part of the annual reviews, particularly those deemed to be high risk. Where annual review reports were attached to the taxpayer's electronic case file, tax risks considered at the annual review were not always clearly outlined. As such, the ANAO requested this information from the ATO for the 2013–14 review year. Following a search of case files and other records, the ATO provided this information. As at July 2014, a total of 18 tax risks were high risk and unresolved: eight relating to GST and excise; nine to income tax; and one to FBT.

4.57 As discussed previously, the ATO and the taxpayer develop mitigation strategies for high risks. The ATO provided details of the mitigation strategies for the 18 risks unresolved in 2013–14. The mitigation strategies were dependent on the nature of the risk: six risks were mitigated through further review, including audit; two were mitigated through the taxpayer seeking a ruling; two through the ATO and taxpayer agreeing on a methodology to calculate the tax; one by the taxpayer implementing revised procedures; and seven mitigation strategies were not finalised, as at August 2014, as the ATO was awaiting more information.

4.58 The review of tax risks and disclosures, throughout the year and at the end of the year, are the two key features of an ACA according to ATO guidance.¹¹⁶ Despite this, there is little documentation to reveal the extent of monitoring and oversight of taxpayers' tax risks and disclosures by the ATO, in particular by the ACA Oversight Committee. As mentioned previously, the ATO was not able to readily provide information on the number of issues disclosed by the taxpayer or identified by the ATO at the end of year review and despite considerable effort and assistance from ATO staff, the ANAO was also not able to locate this information on the ATO's electronic case management system. To complement the monitoring of issues disclosed or identified throughout the year (discussed at paragraphs 4.35 to 4.45), the ATO could also more closely monitor issues disclosed or identified at the end of year review.

116 ATO, *Large business Annual Compliance Arrangements* process map, available from <<https://www.ato.gov.au/Business/Large-business/In-detail/Compliance-and-governance/Annual-Compliance-Arrangements/>> [accessed 7 June 2014].

4.59 As discussed previously, the ATO's 2020 vision states that the level of intensity of compliance activity (high touch to no touch) will be tailored according to the level of risk associated with different taxpayers. This suggests that the intensity of the voluntary ACA administrative processes would be lighter than other compliance activities in which taxpayers are compelled to participate, as ACA taxpayers are considered to be more transparent about their tax affairs.

4.60 The ATO has recognised that ACAs fit well with its 2020 vision, and the views from taxpayers indicate that administrative processes relating to ACAs could be reduced over time where taxpayers demonstrate an increased level of transparency. It would be prudent for the annual review process to be used to determine the level of risk associated with, and the extent of future compliance activity for, each ACA taxpayer. This approach would need to be supported by the ATO developing guidance about the nature of, and basis for, any 'lighter touch'.

Recording of ACA information and documents

4.61 It is an ATO corporate requirement for officers to store all information relating to ACAs on the enterprise wide case management system. Despite this, some compliance teams are using local drives to store documents. The ANAO identified many instances where key documents had not been stored on the case management system. In most instances ATO officers were able to provide these documents from their local and share drives, however, there were instances where the ATO was not able to produce key documentation relating to ACAs, and in particular disclosures and annual review.

4.62 ATO officers commented negatively about the suitability of the case management system for managing ACAs. This was because of the vast amount of documents and records needed to manage the relationship and the frequency of communication. The case management requirements can be administratively burdensome for officers because of the number of activities, tasks, procedures, templates and reporting activities that need to be undertaken, particularly where there is duplication. The ATO has also recognised problems with its electronic case management system as a document management system in a recent quality assurance review. For this review, paper copies of files were created to allow reviewers to undertake their assessment. There is a need for the ATO to monitor the recording of information and documents related to ACAs.

Meeting ACA case management timeframes

4.63 The ATO has developed target cycle times for each of the seven case types used to manage ACAs in its electronic case management system.¹¹⁷ The cycle time is the time between the start and finish of each particular stage. For example, the cycle time to negotiate an income tax ACA is 90 days. This means that the PG&I BSL expects the negotiation of an ACA to be completed within three months.

4.64 The target and actual average cycle times, as well as the percentage difference from the target time, for all cases since ACAs commenced in 2008 are presented in Table 4.5.

Table 4.5: Timeliness of ACA cases—target and actual cycle times

Case name	Tax(es) covered	Target cycle time (days)	Average cycle time (days)	Difference from target (per cent)
Negotiation Phase				
Income tax Large ACA Negotiation	Income tax	90	326	262
PRRT ACA Negotiation	PRRT	180	171	-5
Compliance Arrangement Negotiation	GST, Excise and FBT	360	325	-10
Review Phase				
Income tax Large ACA Review	Income tax	730	490	-33
PRRT ACA Review	PRRT	120	323	169
Compliance Arrangement Maintenance Review	GST, Excise and FBT	365	287	-21
Post-review Phase				
Income tax Large Risk Mitigation	Income tax	365	592	62

Source: ANAO analysis.

4.65 As can be seen from Table 4.5, the target cycle times are not aligned across the case management system case types for each phase. For example, the negotiation case for income tax has a target cycle time of 90 days and the negotiation case for GST, excise and FBT has a target cycle time of 360 days.

¹¹⁷ Each case type has been developed by the ATO to manage a particular aspect of the ACA.

This may be problematic when negotiating a multi-tax ACA that includes income tax and GST because the PG&I officers are aiming to complete the negotiation phase within 90 days and the ITX officers are aiming to complete negotiation within 360 days.

4.66 The ANAO reviewed the case management files to determine whether target cycle times were met. The results, presented in Table 4.5, indicate that in many instances the ATO is not meeting its target cycle times. Most notably, the difference of the average cycle time from the target was 262 per cent for income tax ACA negotiations and 62 per cent for income tax risk mitigation.

4.67 It was also evident that, despite an internal minute providing advice on recording the commencement date, ATO officers are commencing cases at different times. The ATO's 2012 *Review of Annual Compliance Arrangements* also found that there was some inconsistency in recording the time that teams were commencing cases.

4.68 The ATO advised that meeting cycle times is generally important. Two taxpayers have commented to the ANAO and the ATO that timeliness is not as important under an ACA as the relationship is ongoing and not defined by meeting certain timeframes. Notwithstanding this, the ATO does monitor cycle times. The PG&I BSL monitor cycle times through site reporting which includes a section that monitors 'over or near cycle times'.¹¹⁸ This includes monitoring of ACA cases. In the ITX BSL, cycle times are monitored by the ITX Executive via monthly review processes, as well as through other reporting such as aged case reports, cycle time reports and case validation reports. In the PGH BSL, cycle times are monitored through reporting to the Assistant Commissioner.

4.69 Recognising that the ATO monitors timeliness in relation to ACA cases, the ANAO's analysis suggests that the timeliness targets may be unrealistic in some cases. In this light, the ATO should review target cycle times with a particular focus on the differences across BSLs.

118 Near cycle time is defined as elapsed days are greater than 75 per cent of the cycle time.

Quality assurance

4.70 The ATO does not regularly carry out quality assurance work of ACA cases. However as discussed in Chapter 1, in February 2014, the ATO did undertake a Community Involvement Workshop (CIW) on six income tax ACA cases. The CIW was undertaken to:

- help assure the integrity and transparency of the decision-making and operational processes;
- contribute an independent perspective of and contribution to business performance and process improvement;
- identify any potential opportunities for improvement; and
- review the quality framework for the ACA.

4.71 The CIW made five recommendations around the areas of: staffing and support; process and policy; and quality control.¹¹⁹ Some themes resulting from this CIW were similar to findings from the 2012 *Review of Annual Compliance Arrangements*, including that ACA guidance needed to be updated and the variation in ToA clauses better managed. In addition to these recommendations, the CIW report considered that a virtual network should be established to support consistency of approach and effective service delivery. The report also recommended that ACAs be reviewed to determine if there is a need for ACA-specific instructions on when to use Active Compliance Quality Control activities and templates.¹²⁰

4.72 As at June 2014, the ATO had shared the CIW report with ACA Oversight Committee members and was seeking to develop an implementation plan for the recommendations, with the option for across BSL involvement.

4.73 To increase the relevance of timeframes and to improve the management and recording of information associated with ACA cases, the ATO should provide further guidance to staff on properly recording documents and commencement dates. ACA cases should also be reviewed under the ATO's quality assurance framework, ATO Quality, or under BSL quality assurance processes.

¹¹⁹ The external consultant involved in the CIW made 18 recommendations.

¹²⁰ Active Compliance Quality Control activities and templates refer to the framework of controls in place in the electronic case management system where an Executive Level 2 officer must sign-off plans, recommendations and decisions at key points of each phase.

Conclusion

4.74 The ATO's ACA process map sets out high level tasks and activities for the administration of all ACAs, irrespective of tax type or BSL. The process involves three phases relating to the implementation and annual management of ACAs: negotiation; administration throughout the year; and end-of-year review.

4.75 By design, there are necessarily some differences across ACAs to tailor terms and conditions to the individual circumstances of taxpayers. As noted by ATO reviews and this audit, there is a need for the ATO to have a process in place to manage and monitor deviations from the generic ACA during the negotiation phase. The ANAO also found some inconsistencies in the process that is followed throughout the year and at the end of the year. There is scope for the ACA Oversight Committee as well as individual BSLs to monitor and manage these differences more clearly and purposefully.

4.76 ACA guidance states that the two main requirements of an ACA are that: an ACA taxpayer's governance and tax risk management is sound; and an ACA taxpayer works with the ATO in an open and collaborative way, including through disclosure and ongoing dialogue about material tax risk. Despite this, the ATO does not retain information related to disclosures in a consistent manner and does not analyse disclosure information to monitor the performance of ACAs.

4.77 The recording of information related to ACAs is problematic as documents may be in a variety of locations, not only in the enterprise wide case management system. This means that the ATO does not have assurance that ACAs are properly managed and that all requirements have been met. Nor does it have the capacity to analyse the data provided by ACA holders to assess their effectiveness.

4.78 An analysis of the time taken to complete various stages of the ACA process also shows that in many instances the ATO is not meeting its own timeliness targets and the ANAO's analysis suggests that some of these targets are not realistic. Currently there is no systematic quality assurance review of ACA cases. They should be included in the ATO's enterprise wide quality assurance process or included in quality assurance processes at the BSL level.



Ian McPhee
Auditor-General

Canberra ACT
6 November 2014

Appendices

Appendix 1: Entity's Response



Australian Government
Australian Taxation Office

Second Commissioner of Taxation

Mr Mark Simpson
Acting Group Executive Director
Performance Audit Services Group
Australian National Audit Office
GPO Box 707
CANBERRA ACT 2601

Dear Mr Simpson

Australian National Audit Office Performance Audit of Annual Compliance Arrangements with Large Corporate Taxpayers

Thank you for your letter dated 23 September 2014 and for the opportunity to provide comments on the proposed report on the Annual Compliance Arrangements with Large Corporate Taxpayers.

The ATO agrees with the two recommendations as presented in the section 19 report.

Attached is the ATO response to recommendations (Annexure 1) and summary of our comments to be included in the report (Annexure 2).

I would like to thank the Australian National Audit Office audit team for the cooperative and professional manner they have adopted in working with us on this matter. I look forward to continuing the good working relationship developed in this performance audit.

If you require further information on this matter, please contact James O'Halloran, Deputy Commissioner, Indirect Tax on (02) 6216 1516.

Yours sincerely

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

Acting Second Commissioner
Australian Taxation Office
21 October 2014

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