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Performance Audit

# **Administration of Capital Gains Tax for Individual and Small Business Taxpayers**

Australian Taxation Office

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Canberra ACT  
25 June 2015

Dear Mr President  
Dear Madam Speaker

The Australian National Audit Office has undertaken an independent performance audit in the Australian Taxation Office titled *Administration of Capital Gains Tax for Individual and Small Business Taxpayers*. The audit was conducted in accordance with the authority contained in the *Auditor-General Act 1997*. 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

A handwritten signature in black ink, reading 'Grant Hehir', is positioned above the printed name.

Grant Hehir  
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

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ANAO	Australian National Audit Office
ATO	Australian Taxation Office
ATRO	Australian Tax and Revenue Offices
BDE	Bulk Data Exchange
BSL	Business and Service Line
CEM	Compliance Effectiveness Methodology
CIDC	Client Identification Compliance system
CGT	Capital Gains Tax
DMCS	Data Matching Compliance Strategies
ERM	Enterprise Risk Manager
FTE	Full-time equivalent
HOTSA	Health of the System Assessment
ITAA	<i>Income Tax Assessment Act 1936 (and 1997)</i>
IGT	Inspector-General of Taxation
IQF	Integrated Quality Framework
MIPS	Magnetic Information Processing Services
PBS	Portfolio Budget Statements
PGH	Private Groups and High Wealth Individuals
PG&I	Public Groups and International



RIMS	Risk and Information Management Services
SBC	Small Business Compliance
SB/IT	Small Business and Individual Taxpayers
WinCAS	Windows Case Actioning System



# **Summary and Recommendations**



# Summary

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## Introduction

1. The Australian Taxation Office (ATO) is the Government's principal revenue collection agency. In 2013–14, the ATO processed 16.5 million tax returns and collected \$321.7 billion in net tax—mostly in income tax from individuals (\$163.6 billion) and companies (\$67.3 billion).<sup>1</sup> Income tax revenue is derived from a number of sources such as wages and salaries, investment income (interest and dividends), and business income. One component of income tax collected by the ATO is capital gains tax (CGT).
2. Australia introduced a CGT system in 1985. It was intended to include capital gains as assessable income, reduce tax avoidance practices and promote appropriate capital investment in Australia.<sup>2</sup> Unless specifically excluded, CGT applies to all assets acquired on or after 20 September 1985 and applies to Australian residents' assets anywhere in the world. Foreign residents can also be subject to CGT in accordance with the *Income Tax Assessment Act 1997*.<sup>3</sup> The most common way to make a capital gain is through the sale of tangible assets such as real property<sup>4</sup> or shares. CGT can also apply to intangible assets such as business goodwill and intellectual property. Some common assets that are exempt from CGT include: major personal assets, particularly a taxpayer's private (main) residence and motor vehicle; and most personal use assets, such as furniture.
3. The ATO collects substantial revenue from CGT, in total and from key categories of taxpayers—individuals, companies and superannuation funds. CGT revenue is, however, volatile and influenced by domestic and international economic conditions, such as the global financial crisis, and local factors such as natural disasters. These types of events can affect people's financial behaviour and influence real property and stock markets, which are

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1 ATO, *Annual Report 2013–14*, ATO, Canberra, 2014, p. iii.

2 Senate Hansard, *Income Tax Legislation*, Income Tax Assessment Amendment (Capital Gains) Bill 1986, second reading speech, 4 June 1986, p. 3393.

3 The *Income Tax Assessment Act 1997* (Volume 3) lists 53 CGT events. Events are grouped into categories, including: disposals; trusts; leases; shares; cessation of Australian residency; rollovers; and consolidations.

4 Real property is defined as 'tangible and immovable property such as land and houses, buildings or any such structures on the land, and any rights attached to the ownership of the land, such as mineral rights (but excluding leasehold interests)'. Macquarie Dictionary Online [Internet], available from <<https://www.macquariedictionary.com.au/>> [accessed 19 March 2015].

common sources of capital gains and losses. CGT receipts for 2013–14 were reported as \$7.2 billion.<sup>5</sup>

4. The latest available tax statistics (2010–11 to 2012–13) show that most CGT was paid by individuals (58 per cent), with companies contributing around 37 per cent of the estimated total tax payable on capital gains.<sup>6</sup> Of CGT paid by companies, most was paid by small business (over 45 per cent in 2011–12), with 36 per cent from large and international businesses in the same year and the remainder from medium-sized businesses (18 per cent).<sup>7</sup>

5. While the ATO considers that most taxpayers meet their CGT obligations, it has rated the risk of non-compliance with CGT requirements as ‘high’<sup>8</sup> for the individual taxpayer and small business market segments. This rating is largely due to the complex law design of CGT, the one-off nature of capital events and an absence of reliable data about those events. The ATO undertakes a range of activities designed to assist people to understand and comply with their taxation obligations, including providing educational material and conducting active compliance work through audits, reviews<sup>9</sup> and correspondence.<sup>10</sup>

## Administration of capital gains tax

6. The ATO’s Small Business and Individual Taxpayers Business and Service Line manages the tax and superannuation systems for taxpayers from the small business<sup>11</sup>, individuals and employers markets. At the beginning of 2014–15, it had 2077 full-time equivalent staff located around Australia,

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5 Australian Government, *Budget Strategy and Outlook: Budget Paper No. 1: 2015–16*, Commonwealth of Australia, Canberra, 2015, p. 4–16.

6 ATO, *Taxation Statistics 2012–13*, Table 2: Capital gains tax—Net capital gains subject to tax, by entity type, 1989–90 to 2012–13 income years.

7 ATO, *2013 CGT Health of the System Assessment*, August 2013, p. 10.

8 A ‘high’ rating is a combination of the consequence rating (risk to revenue and reputation, and impact on voluntary compliance) and the likelihood rating (either the frequency of issues in the risk population or probability of the risk occurring).

9 Audits and reviews carried out by the ATO are more resource-intensive examinations of a taxpayer’s income tax affairs. ATO, *How we check compliance* [Internet], ATO, available from <<https://www.ato.gov.au/General/How-we-check-compliance/>> [accessed 8 January 2015].

10 Correspondence is sent to individual taxpayers, pre-filled with information that the ATO identifies as being sourced from third-party records. The correspondence is designed to verify statements of fact and questions whether the taxpayer has met their CGT obligations. The ATO refers to this correspondence as letters, which are sent through bulk mailouts and represent a form of audit.

11 Small businesses that have an aggregated turnover of less than \$2 million annually.

addressing a range of taxation matters affecting those market segments, including CGT.

## Previous performance audit

7. The Australian National Audit Office (ANAO) examined the ATO's administration of CGT compliance in the individuals market segment eight years ago.<sup>12</sup> The focus of the audit was the ATO's administration of compliance by individuals with respect to the two most common CGT events: real property and share disposals. This audit concluded that the ATO's administration of CGT for that market was effective overall. The audit made seven recommendations aimed at improving the ATO's administration of CGT for individuals in the areas of: CGT project planning; data management and risk assessment; and compliance planning. The ATO agreed to all recommendations.

## Audit objective and criteria

8. The objective of the audit was to assess the effectiveness of the Australian Taxation Office's administration of capital gains tax for individual and small business taxpayers.

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

- management arrangements support the effective administration of CGT for individual and small business taxpayers;
- compliance risks are assessed and a coherent strategy is in place to promote compliance with CGT requirements; and
- compliance activities are appropriate and effective.

10. The ANAO focused on CGT activities undertaken in the Small Business and Individual Taxpayers Business and Service Line.<sup>13</sup> The audit also includes a review of the implementation status of the seven recommendations from the 2006–07 ANAO audit report.

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12 ANAO Audit Report No.16 2006–07 *Administration of Capital Gains Tax Compliance in the Individuals Market Segment*.

13 This audit focused on individual and small business taxpayers as these market segments paid the large majority of capital gains, and had some synergies as they were administered in the same business line. It did not cover large corporate taxpayers, as the capital gains events and administration were quite different, and these taxpayers contributed a relatively small share of CGT.

## Overall conclusion

11. Australian taxpayers have been required to include net capital gains<sup>14</sup> as part of their assessable income since 1985 when the capital gains tax (CGT) system was introduced. In 2013–14, CGT receipts were around \$7.2 billion<sup>15</sup>, which represented some 2.2 per cent of the \$321.7 billion total net tax collected by the ATO.<sup>16</sup> Based on the latest ATO estimates, in 2011–12, some 63 per cent of CGT was paid by individual taxpayers, with small business comprising around 14 per cent in that year.

12. The arrangements put in place by the ATO to administer CGT reflect its general approach to taxation administration. The ATO has provided a range of targeted marketing, communication and education activities explaining CGT requirements and encouraging compliance by individual and small business taxpayers, which are the focus of this audit. The ATO has also implemented sound management arrangements and suitable risk management processes to administer CGT for these taxpayers. Nevertheless, CGT presents particular compliance challenges for taxpayers intending to fulfil their tax obligations and administrative challenges for the ATO—essentially related to the one-off nature of capital events, extensive record keeping requirements for taxpayers and reliance on third-party data by the ATO, particularly for compliance activity with individual taxpayers. As a result, CGT has been classified as a high compliance risk for the ATO, requiring effective approaches to risk mitigation and active management oversight to monitor performance.

13. While the ATO's general approach to the administration of CGT is sound, there has been a heavy reliance on taxpayers' voluntary disclosures of CGT liabilities in their annual tax returns. Insufficient attention has been given to addressing the limited effectiveness of compliance activities for individual and small business taxpayers that have not met their CGT obligations. As a consequence, there has been a considerable reduction in the revenue raised from specific CGT compliance activities directed at individual and small business taxpayers in recent years. This aspect of CGT administration requires closer consideration by the ATO.

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14 A net capital gain is the difference between total capital gains for the year and total capital losses, including capital losses from prior years.

15 Australian Government, *Budget Strategy and Outlook: Budget Paper No. 1: 2015–16*, Commonwealth of Australia, Canberra, 2015, p. 4-16.

16 ATO, *Annual Report 2013–14*, ATO, Canberra, 2014, p. iii.



14. In relation to compliance activities, the ATO has programs for CGT that take into account the different elements of the individual and small business taxpayer market segments. CGT compliance activities for individual taxpayers are primarily conducted through correspondence (letters that draw on third-party data), while reviews and audits are conducted for small business taxpayers.<sup>17</sup> These active compliance programs raised some \$546 million in liabilities from 2011–12 to 2013–14<sup>18</sup>, of which around 30 per cent (\$149 million) has been collected. Further, the liabilities raised and cash collected from these targeted CGT compliance activities are relatively small amounts in comparison to the voluntary disclosure of capital gains. The latest available ATO data indicates that in 2011–12 the estimated total tax payable on capital gains made by individual and small business taxpayers was around \$4.3 billion, with around \$150 million in liabilities raised and only \$46 million (31 per cent) in cash collected from compliance activities conducted in that year.

15. To support the CGT compliance letter strategy for individual taxpayers, the ATO obtains extensive data from third-parties in relation to real property and share transactions.<sup>19</sup> Although the ATO has implemented extensive data cleansing and filtering processes, problems in matching this data to taxpayer declarations<sup>20</sup> limits the number of CGT cases the ATO reviews and the accuracy of the potential non-compliance that is identified. As a consequence, the active compliance programs for individual taxpayers have had a heavy emphasis on real property and a limited focus on shares and other types of assets. To achieve a more balanced coverage across asset types, there would be merit in the ATO reassessing its capacity to target compliance activities for individual taxpayers across all asset types.

16. Despite the known problems with third-party data, the ATO sends letters to thousands of individual taxpayers each year, questioning the accuracy

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17 Over the period 2011–12 to 2013–14, the ATO finalised: 26 391 individual taxpayer cases by letter; and for small businesses 721 cases by review and 677 cases by audit.

18 The ATO raised \$402.2 million in liabilities for individual taxpayers and \$143.5 million in liabilities for small businesses. Non-compliance generally arose either through omitting or incorrectly reporting capital gains in income tax returns.

19 Real property data is obtained from state and territory revenue offices, land titles registries, and tenancy authorities. Share transaction data is obtained from the Australian Securities Exchange (ASX Limited) and five share trading registries.

20 For real property, data limitations arise mainly from the lack of detail about the vendor (who may have made a capital gain)—most information is in regard to the purchaser of the property. In respect of share data, a high incidence of split purchases and sales contributes to difficulties for the ATO in calculating capital gains.

of their declarations of CGT. The outcome of this correspondence can be that the taxpayer contacts the ATO and clarifies their situation to the satisfaction of the ATO, or the ATO amends their assessment. The ANAO's sample of 322 letters sent to individual taxpayers<sup>21</sup> found that most did not result in further action by the ATO (59 per cent) and that many (almost half) of the amended assessments were subsequently reversed. This largely reflects a lack of accuracy of information in these letters, which impacts on the taxpayer's experience and the ATO's prospects of securing appropriate revenue. On this basis, the ATO would benefit from evaluating the effectiveness of its CGT bulk letter compliance strategy for individual taxpayers.

17. As mentioned previously, there has also been a significant reduction in revenue from specific CGT compliance activities for small business taxpayers—from \$59.0 million to \$30.3 million from 2011–12 to 2013–14. In 2014–15, the ATO expects to raise only \$13.1 million from 32 specific CGT small business cases, and to incorporate CGT into the broader small business compliance program. To gain assurance that its CGT compliance strategies for individual and small business taxpayers are targeted effectively across the major categories of CGT events and, in the light of recent changes to CGT administrative arrangements<sup>22</sup>, it is important for the ATO to evaluate its strategies and activities.

18. To support the ATO's administration of CGT, the ANAO has made one recommendation aimed at improving the effectiveness of CGT compliance strategies and activities for individual and small business taxpayers.

## Key findings by chapter

### Management Arrangements (Chapter 2)

19. The management arrangements in place in the Small Business and Individual Taxpayers (SB/IT) Business and Service Line (BSL) are appropriate to support the administration of CGT for individual and small business taxpayers. Two separate business units within the BSL undertake compliance

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21 The ANAO drew an initial sample of 414 cases, which was reduced to 377 after excluding duplicates from the data provided by the ATO, and then to 322 cases, as a number of letters were not actually sent to taxpayers.

22 In recent years, some specific CGT compliance activities for small business taxpayers have moved to other areas of the ATO, as well as to the broader small business compliance program. There has also been a strengthening of manual processes to check the accuracy of information in letters to individual taxpayers before they are sent.

activity for CGT: Data Matching Compliance Strategies (DMCS) for individual taxpayers; and Small Business Compliance (SBC) for small business taxpayers. High-level planning for SB/IT aligns with the ATO's corporate direction and more detailed planning is undertaken by these two business units. While performance monitoring and reporting activities for CGT in the BSL are suitable, CGT activities are not among the headline topics routinely monitored and reported to senior management, even though there has been a high risk rating in both the individuals and small business market segments for CGT.<sup>23</sup>

20. Despite significant decreases in revenue targets for CGT compliance activities involving individual and small business taxpayers in the last three years (of 44 per cent and 80 per cent respectively)<sup>24</sup>, the revenue achieved for DMCS and SBC has been variable and neither market segment exceeded 85 per cent of its original target in a single year. The ATO identified a range of factors that contributed to these trends, including changes in the composition of revenue targets at the team level and the reallocation of staff and work to other areas in the ATO. In this regard, the ATO advised that SB/IT staff reductions have been offset by advancements in technology and improved work practices, which support BSL revenue commitments; however, the benefits from these advancements and work practices have not been demonstrated or quantified.

21. Going forward, there is considerable uncertainty about CGT compliance activity and the potential revenue from individual and small business taxpayers. The number of CGT specific review and audit cases in 2014–15 has reduced considerably in SBC and the benefits of incorporating CGT cases into the broader small business compliance program are yet to be confirmed. There is also uncertainty about the timing and impact on CGT compliance activity outcomes for individual taxpayers in relation to the implementation of the 2013–14 Budget measure.<sup>25</sup> Given these developments, and the volatility of CGT revenue, the ATO needs to closely monitor the

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23 A recent exception was the preparation of information and advice for relevant ATO senior executives to support the 2013–14 Budget measure for third-party data.

24 The original revenue target (before a mid-year review) for individual taxpayers was \$250 million in 2011–12 and \$140 million in 2014–15. The original small business revenue target for CGT was \$65 million in 2011–12 and \$13.1 million in 2014–15.

25 The Budget measure, *Tax compliance—improving compliance through third-party reporting and data matching*, is designed to improve compliance and increase taxation revenue by expanding the ATO's data matching with third-party data relating to the sale of real property, shares and units in managed funds.

effectiveness of its administration and fine tune its approach in the light of experience to date.

### **Managing Compliance Risks (Chapter 3)**

22. Risk planning for CGT takes account of ATO-wide market risks that are identified in annual planning processes and endorsed and monitored at a senior executive level. While these processes have been sound, the nature of the CGT system—including very little change over time in the identified risk events<sup>26</sup> and participants—means that, without changes in legislative design, the CGT risk is likely to continue to be rated as high for the individuals and small business taxpayer market segments.

23. The management of CGT risk by SB/IT from 2010 to 2014 was appropriate and in accordance with the ATO's corporate risk management process for compliance risks, which requires the preparation of a risk assessment, risk treatment plan and risk review. Both SBC and DMCS prepared these documents, and SBC also prepared target selection rationales and treatment evaluations, to guide operational activities for CGT compliance.

24. In conducting these risk processes, DMCS and SBC, for the most part, appropriately identified and assessed compliance risks for individual and small business taxpayers, respectively. While SBC is addressing emerging risks involving obtaining essential valuations for compliance cases and staffing changes that impact on the type of audit activity, these issues were not included in existing risk assessments. As significant organisational changes can also affect the administration of CGT, it is important that they are considered in annual risk reviews in the small business market sector.

### **Selecting Cases for Compliance Activity (Chapter 4)**

25. Data matching activities for CGT enable the ATO to apply computer assisted data matching processes to third-party data to identify individual taxpayers outside the tax system, non-lodgers or discrepancies in taxpayer information, to identify potential non-compliance. As previously discussed, the ATO obtains third-party data from state and territory governments, the Australian Stock Exchange and selected share trading registries in relation to

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26 Common risk events for the individual and small business market segments include: taxpayers incorrectly claiming concessions and under-reporting or omitting CGT; and tax agents failing to ask the right questions or providing incorrect advice.

real property and share transactions to use for CGT data matching activities for individual taxpayers. This high degree of automation for case selection in DMCS generates thousands of potential cases each year (6153 CGT cases were finalised in 2013–14 from approximately 17 million new records received).

26. In contrast, SBC generally sources cases by analysing data held in ATO databases, such as in relation to: small business assets, income and liabilities; information on CGT schedules; and whether a small business concession was claimed. Considerably fewer potential cases are selected by SBC from such data analysis (406 CGT cases were finalised in 2013–14). The different arrangements in place for selecting taxpayer cases for CGT compliance action are generally appropriate for the different market segments.

27. The ANAO assessed the IT control framework for CGT data matching for individuals, including its design and the operation of matching rules, which support the selection of compliance cases. The main elements in the control framework are data capture, identity matching and discrepancy matching.<sup>27</sup> The control framework supporting data matching for individual taxpayer compliance cases is mature and effective for CGT purposes.

28. Since the ANAO's 2006–07 audit of CGT<sup>28</sup>, the ATO has concluded negotiations with all state and territory governments for the acquisition of real property data. This enabled the ATO to achieve national coverage for its CGT case selection and compliance activities for individual taxpayers. However, despite ongoing work with third-party data providers to improve the quality of the real property data received by the ATO, there have been no significant improvements in the ATO's data matching processes or outcomes for CGT in the individual taxpayers market segment in recent years. The ATO is relying on legislation being passed by the Parliament implementing a 2013–14 Budget measure for third-party data, which is intended to substantially improve the data used to identify non-compliance with CGT obligations by individual

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27 Data matching algorithms are used to identify potential CGT discrepancies, including omissions in taxpayers' income tax reporting.

28 ANAO Audit Report No.16 2006–07 *Administration of Capital Gains Tax Compliance in the Individuals Market Segment*.

taxpayers.<sup>29</sup> There is currently a two-year deferral for the introduction of the legislative elements of this Budget measure, from 1 July 2014 to 1 July 2016.

## **Encouraging Voluntary Compliance (Chapter 5)**

29. The ATO seeks to foster willing participation among taxpayers in the tax system as well as deal with non-compliance through compliance activities that seek to verify information or enforce tax law.<sup>30</sup> It employs a variety of delivery channels to assist individual and small business taxpayers to understand and voluntarily comply with their CGT obligations including providing information and tools on the ATO website, email bulletins, and electronic and paper publications. There would be benefit in the ATO evaluating its communication strategies for CGT to gain assurance that communication activities are supporting individual taxpayers and their tax professionals to voluntarily comply with CGT obligations.

30. In the last three years (2011–12 to 2013–14), the ATO also finalised almost 4000 interpretive assistance products. These products are designed to help taxpayers by providing the Commissioner of Taxation's opinion about the application of taxation laws. Private rulings (3126) primarily covered matters relating to: deceased estates; small business concessions; main residence exemptions; shares; subdivisions; and trusts. The ATO has improved its timeliness in finalising CGT private rulings in the last three years, which have a potential financial impact for both taxpayers and the ATO.

## **Conducting Compliance Activities (Chapter 6)**

31. In the last three years, SBC finalised approximately 1400 CGT review and audit cases for small businesses, raised \$143.5 million in liabilities and collected \$33.6 million (23 per cent) in cash.<sup>31</sup> SBC intends to undertake only 32 CGT cases in 2014–15, with a target of \$13.1 million in liabilities raised,

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29 A recent report by the Inspector-General of Taxation, in the context of the 2013–14 Budget measure, highlighted the desirability of improving the ATO's compliance processes through more effective data matching. This outcome is also supported by the ANAO. Inspector-General of Taxation, *Review into the Australian Taxation Office's compliance approach to individual taxpayers—use of data matching*, IGT, Sydney, 2013, p. 43.

30 *ATO corporate plan 2014–18*.

31 The cash collected amount includes: actual data for cases based on matching ATO account records of payments received and compliance case transactions; and an estimate of the value of cases where payments could not be attributed directly to CGT compliance activities. The ATO advised that for those cases where there is not a match, a sample rate is applied based on similar cases to estimate the cash collected. The cash collected also represents a point in time calculation as additional payments are likely to be received in the following year after a case was finalised.



which is a significant decrease in the number of planned cases and potential liabilities compared to recent years.<sup>32</sup> SBC advised that CGT work in 2014–15 will be included as a component of the other compliance cases it conducts with selected small businesses.

**32.** The ANAO analysed 95 small business cases for CGT that were finalised in the last two years (2012–13 to 2013–14) (approximately seven per cent of the cases finalised). The ANAO found that 26 cases (27 per cent) in the sample had liabilities raised, totalling \$13.6 million—ranging from \$5.8 million for a single case to a negative liability (an amendment in the taxpayer’s favour) of approximately \$229 000. Most of the 95 cases were finalised by SBC within the expected cycle time (60 cases or 63 per cent), although these cases represented less than four per cent of the total liabilities raised. Conversely, 18 cases took in excess of 50 days beyond the cycle time to be finalised, but accounted for approximately 96 per cent (\$13 million) of the total liabilities raised of \$13.6 million. These findings highlight the importance of the ATO placing sufficient emphasis on liabilities raised from longer audits when balancing timeliness and financial outcomes in finalising small business CGT compliance cases.

**33.** For individual taxpayers, DMCS conducts its compliance cases through a series of bulk letter mailouts. Including a two-year pilot (in 2009–10 and 2010–11), approximately 27 000 cases have been finalised in the last five years using this approach, raising approximately \$409 million in liabilities. The ANAO examined a sample of 322 CGT cases finalised by DMCS in 2012–13 and 2013–14. Around 40 per cent of those cases where letters were sent to taxpayers resulted in either an amended income tax assessment, the lodgement of a tax return or default assessment for taxpayers who had not previously lodged a tax return. However, almost half of those cases with an amended income tax assessment had an administrative reversal<sup>33</sup> that substantially reduced the initial liability raised.

**34.** As previously discussed, in the last two years, DMCS CGT letters have resulted in the ATO contacting thousands of individual taxpayers with advice about the possibility of amending assessments because of the inaccurate

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32 Compared to 2013–14, this is a 92 per cent reduction in cases and 57 per cent reduction in the liabilities to be raised.

33 Based on evidence from the taxpayer, an ATO case officer reverses or reduces an adjustment without the taxpayer lodging a formal objection.

self-assessment of CGT. While recognising that the ATO has recently strengthened processes to manually check the accuracy of the information contained in these letters, the results of the ANAO's analysis of cases reviewed for 2012–13 and 2013–14 revealed a high proportion of letters (191 of the 322 letters sent or 59 per cent), that did not result in further action by the ATO. To better target letters at non-compliant taxpayers, the ATO should evaluate the use of bulk mailouts for CGT compliance and identify ways to increase their effectiveness. An evaluation of CGT compliance strategies across all relevant market sectors (using the ATO's Compliance Effectiveness Methodology<sup>34</sup>) would extend the benefits of the recommended evaluations of CGT effectiveness focusing on individual and small business taxpayers.

35. In the last three years, the objection rate for CGT compliance cases for individual and small business taxpayers was low (2031 finalised objections, or 7.3 per cent of finalised compliances cases), and over half of those objections were allowed in full or in part each year in the taxpayer's favour. Each year, from 2011–12 to 2013–14, SB/IT's timeliness performance for finalising CGT objections exceeded the ATO's corporate standard of 70 per cent of objections being finalised in 56 calendar days of receiving the necessary information.<sup>35</sup>

## Summary of entity response

36. The ATO's formal response is included at Appendix 1.

The ATO welcomes this review and the finding that the ATO's compliance approach toward the administration of CGT for small businesses and individuals is generally effective.

In relation to your finding that CGT revenue targets have not been met in recent years, we would note the impact of The Global Financial Crisis (GFC) on asset values. Many of the potential gains that relate to assets that were disposed of were not able to be realised following the GFC in both the individual and small business markets. We appreciate that you have recognised the volatile nature of CGT revenue due to market forces.

The ATO also would like to highlight that significant improvements have been made to our processes for CGT in the individual market segment. Using a variety of new data matching techniques, such as cross matching against other

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34 In 2006, the ATO introduced a Compliance Effectiveness Methodology (CEM) to better measure the effectiveness of its compliance activities. The ANAO examined the application of the CEM in ANAO Audit Report No.39 2013–14 *Compliance Effectiveness Methodology*.

35 In the last two years, over 80 per cent of objections were finalised within the ATO standard.



data sources and reviewing prior year results, strike rates have improved over the three year period from 47% to 70%. This has also resulted in better targeted and reduced volumes of letters issuing to the community.

The ATO agrees with the one recommendation made in the report and recognises the audit highlights opportunities to further improve the effectiveness of our CGT compliance strategies.

# Recommendations

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## **Recommendation No.1**

### **Paragraph 6.42**

To determine the effectiveness of its capital gains tax (CGT) compliance strategies and activities, the ANAO recommends that the ATO:

- (a) undertakes an evaluation of the bulk mailout of letters to individual taxpayers for potential non-compliance with CGT obligations;
- (b) further assesses the effectiveness of CGT reviews and audits of small business taxpayers; and
- (c) conduct an evaluation for CGT that includes all the relevant market sectors using the Compliance Effectiveness Methodology.

**ATO response:** *Agreed.*

## **Audit Findings**



# 1. Background and Context

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*This chapter provides background information about the administration of capital gains tax, and explains the audit approach and structure of the report.*

## Introduction

**1.1** The Australian Taxation Office (ATO) is the Government's principal revenue collection agency. The ATO's roles and objectives are to effectively and fairly administer the taxation system, regulate aspects of the superannuation system, and support the delivery of government benefits to the community. In 2013–14, the ATO had an operating budget of \$3.6 billion and approximately 23 600 staff. During the period, the ATO processed 16.5 million tax return lodgements and collected \$230.9 billion in income tax from individuals (\$163.6 billion) and companies (\$67.3 billion).<sup>36</sup>

**1.2** Income tax revenue is derived from a number of sources such as wages and salaries, investment income (interest and dividends), and business income. One component of the total income tax collected by the ATO is capital gains tax (CGT).<sup>37</sup>

## Capital gains tax

**1.3** The ATO explains CGT as follows:

A capital gain or capital loss is the difference between what it cost you to get an asset and what you received when you disposed of it. You pay tax on your capital gains.<sup>38</sup>

**1.4** There are a number of transactions or events that may result in a capital gain or capital loss.<sup>39</sup> While 53 CGT events are listed in the *Income Tax Assessment*

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36 ATO, *Annual Report 2013–14*, ATO, Canberra, 2014, p. iii.

37 The operation of CGT is defined in the *Income Tax Assessment Act 1997*, Volumes 3 and 4. As a component of income tax, CGT can be declared by individuals, companies or funds in an annual income tax return.

38 For most CGT events, the capital gain or loss is calculated by subtracting the 'cost base' (the cost to obtain an asset) from the 'capital proceeds' (the receipts from disposing of the asset). ATO, *Capital Gains Tax* [Internet], ATO, available from <<https://www.ato.gov.au/General/Capital-gains-tax/>> [accessed 8 May 2015].

39 A capital loss cannot be claimed against income, but can be used to reduce a capital gain in the same income year. If capital losses exceed capital gains, or taxpayers make a capital loss in an income year they do not have a capital gain, the loss can generally be carried forward and deducted against capital gains in future years.

*Act 1997 (ITAA 1997)*, the most common way to make a capital gain or loss is through the sale of assets such as real property<sup>40</sup> or shares, although CGT can also apply to intangible assets such as business goodwill and intellectual property.<sup>41</sup> Some assets are also exempt from CGT, including:

- major personal assets, particularly a private (main) residence and motor vehicle, and most personal use assets, such as furniture; and
- depreciating assets used solely for taxable purposes, for example, business equipment or fittings in a rental property.

**1.5** In addition to the exemptions and rollovers for CGT, four types of small business<sup>42</sup> CGT concessions are available to provide relief from the CGT system, subject to entities meeting specific conditions. The concessions are the:

- 15-year exemption—provides a total exemption for a capital gain on a CGT asset if an asset has been continuously owned by an individual in business who is 55 years old or older and is retiring or permanently incapacitated;
- 50 per cent active asset reduction—provides a 50 per cent reduction of a capital gain if the taxpayer is a small business and the ‘active asset’ test can be met. A CGT asset is an active asset if it is owned by the individual and connected to carrying on a business;
- retirement exemption—can exempt a capital gain on a CGT asset up to a lifetime limit of \$500 000; and
- rollover—allows a taxpayer to defer all or part of a capital gain on a business asset for a minimum of two years.

## **Introduction of CGT**

**1.6** When the Hawke Government introduced the CGT in 1985, a similar type of the tax existed in many countries including Great Britain, the

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40 Real property is defined as ‘tangible and immovable property such as land and houses, buildings or any such structures on the land, and any rights attached to the ownership of the land, such as mineral rights (but excluding leasehold interests)’. Macquarie Dictionary Online [Internet], available from <<https://www.macquariedictionary.com.au/>> [accessed 19 March 2015].

41 Events are grouped into categories, including: disposals; trusts; leases; shares; cessation of Australian residency; rollovers; and consolidations.

42 Small businesses have an aggregated turnover of less than \$2 million annually. Medium-sized businesses have aggregated annual turnover from \$2 million to \$250 million and large businesses a turnover of more than \$250 million.

United States, Japan and Switzerland. The CGT system was intended to: include capital gains as assessable income; reduce tax avoidance practices; and promote appropriate capital investment in Australia.<sup>43</sup>

**1.7** Unless specifically excluded, CGT applies to all assets acquired on or after 20 September 1985. CGT also applies to Australian residents' assets anywhere in the world.<sup>44</sup> In addition, foreign residents can be subject to CGT, in accordance with the ITAA 1997 (Division 855).

## Revenue from CGT

**1.8** The ATO collects substantial revenue from CGT, in total and from key categories of taxpayers—individuals, companies and superannuation funds. CGT revenue is, however, volatile and influenced by domestic and international economic conditions, such as the global financial crisis, and local factors such as natural disasters. These events can affect people's financial behaviour and influence the real property and stock markets.

**1.9** The latest available tax statistics (2010–11 to 2012–13) show that most CGT was paid by individuals (58 per cent) during this period, with companies contributing around 37 per cent of the estimated total tax payable on capital gains (Table 1.1).<sup>45</sup> Of CGT paid by companies, most was paid by small business (over 45 per cent in 2011–12), with 36 per cent from large and international businesses in the same year, and the remainder from medium-sized businesses (18 per cent).<sup>46</sup>

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43 Senate Hansard, *Income Tax Legislation*, Income Tax Assessment Amendment (Capital Gains) Bill 1986, second reading speech, 4 June 1986, p. 3393.

44 ATO, *Capital Gains Tax* [Internet].

45 ATO, *Taxation Statistics 2012–13*, Table 2: Capital gains tax—Net capital gains subject to tax, by entity type, 1989–90 to 2012–13 income years.

46 ATO, *2013 CGT Health of the System Assessment*, August 2013, p. 10.

**Table 1.1: Entity type and net capital gains, 2010–11 to 2012–13**

	2010–11	2011–12	2012–13
<b>Individual taxpayers</b>			
Number of individual taxpayers	13 275 055	13 182 415	12 776 080
Number with taxable net capital gains	465 340	354 580	389 415
Net capital gains (\$ million)	11 874	9 107	9 327
Estimated tax payable on gains (\$ million)	3 910	3 024	3 127
<b>Companies</b>			
Number of companies	870 550	879 175	854 790
Number with taxable net capital gains	9 765	8 465	8 770
Net capital gains (\$ million)	7 194	6 292	10 506
Estimated tax payable on gains (\$ million)	1 835	1 713	2 838
<b>Superannuation funds</b>			
Number of funds	424 905	448 015	451 625
Number with taxable net capital gains	52 585	42 905	52 070
Net capital gains (\$ million)	2 188	1 481	1 703
Estimated tax payable on gains (\$ million)	360	243	260
<b>Total number with net capital gains</b>	<b>668 460</b>	<b>510 530</b>	<b>576 175</b>
<b>Total net capital gains (\$ million)</b>	<b>24 282</b>	<b>19 320</b>	<b>23 869</b>
<b>Estimated tax payable on gains (\$ million)</b>	<b>6 106</b>	<b>4 980</b>	<b>6 226</b>

Source: ATO, *Taxation Statistics 2012–13*, Table 2: Capital gains tax—Net capital gains subject to tax, by entity type, 1989–90 to 2012–13 income years.

Note: Totals are as presented in the source table, with some totals not equalling the sum of the components due to rounding.

**1.10** In 2012–13, the estimated tax payable on net capital gains<sup>47</sup> (\$6.2 billion) represented two per cent of the total net tax collected by the ATO (\$311.7 billion) in that year.<sup>48</sup> In the 2015–16 Federal Budget, CGT receipts for 2013–14 were reported as \$7.2 billion<sup>49</sup> (some 2.2 per cent of the \$321.7 billion total net tax collected by the ATO).<sup>50</sup>

47 Net capital gains are the total capital gains for a year minus total capital losses (including losses carried forward), and minus any CGT discount or small business concession.

48 ATO *Annual Report 2012–13*, ATO, Canberra, 2013, p. vi.

49 Australian Government, *Budget Strategy and Outlook: Budget Paper No. 1: 2015–16*, Commonwealth of Australia, Canberra, 2015, p. 4–16.

50 ATO, *Annual Report 2013–14*, ATO, Canberra, 2014, p. iii.



## ATO administration of CGT

**1.11** Responsibility for the administration of CGT rests with the Second Commissioner for Compliance, and the tax is administered in the Compliance Group. Within this group, the Small Business and Individual Taxpayers (SB/IT) Business and Service Line (BSL) manages the tax and superannuation systems for taxpayers from the small business, individuals and employers markets. CGT is one component of these activities.<sup>51</sup> At the beginning of 2014–15, SB/IT had 2077 full-time equivalent staff located around Australia, and received a budget allocation of \$173.1 million.

## Compliance activities

**1.12** The ATO undertakes a range of activities designed to assist people to understand and comply with their taxation obligations, including providing educational material and conducting active compliance work. Compliance activities—audits, reviews<sup>52</sup> and correspondence<sup>53</sup>—are to be undertaken in a way that is consistent with the principles in the ATO's *Taxpayers' Charter* for client service. In 2013–14, the ATO undertook CGT compliance activity in all major market segments, including the individuals and small business markets.<sup>54</sup>

**1.13** The generic behavioural drivers for taxpayer non-compliance range from lack of understanding through to calculated tax minimisation and deliberate tax avoidance. While the ATO considers that most taxpayers meet their CGT obligations, it has rated the risk of non-compliance with CGT requirements as 'high'<sup>55</sup> for the individual taxpayer and small business market segments. This rating is largely due to complex law design, the one-off nature of capital events and an absence of reliable data about those events.

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51 Other BSLs have an interest in CGT. For example, work in the Aggressive Tax Planning area (in Private Groups and High Wealth Individuals) may identify a promoter of a scheme using CGT for avoidance, while an audit of serious non-compliance may include CGT components.

52 Audits and reviews carried out by the ATO are more resource intensive examinations of a taxpayer's income tax affairs. ATO, *How we check compliance* [Internet], ATO, available from <<https://www.ato.gov.au/General/How-we-check-compliance/>> [accessed 8 January 2015].

53 Correspondence is sent to individual taxpayers, pre-filled with information that the ATO identifies as being sourced from third-party records. The correspondence is designed to verify statements of fact and questions whether the taxpayer has met their CGT obligations. The ATO refers to this correspondence as letters, which are sent through bulk mailouts and represent a form of audit.

54 ATO, *Compliance in focus 2013–14* [Internet], ATO, available from <<https://www.ato.gov.au/about-ato/research-and-statistics/in-detail/general-statistics/compliance-in-focus-2013-14/>> [accessed 4 November 2014].

55 A 'high' rating is a combination of the consequence rating (risk to revenue and reputation, and impact on voluntary compliance) and the likelihood rating (either the frequency of issues in the risk population or probability of the risk occurring).

## Legislative design

**1.14** For several years, the ATO has identified a number of problems with the current design of the CGT system and considers that these inherent weaknesses undermine the system's effectiveness. They include:

- increasing legislative complexity, as well as interactions with other tax law;
- the absence of comprehensive, matchable third-party reporting to alert the ATO of potential CGT liability;
- inadequate CGT data being captured on tax returns to enable assessments of the risk of non-compliance; and
- the absence of a CGT withholding regime.<sup>56</sup>

**1.15** The ATO considers that the substantial volume of guidance material produced for taxpayers about CGT reflects the growing legislative complexity of the CGT system. This view is supported by coverage of CGT in the *Australian Master Tax Guide* (June 2014)—a tax reference manual designed for practitioners, businesses, other organisations and students. The latest edition of the guide is over 2000 pages and contains almost 200 pages (10 per cent) dedicated to general and special CGT matters.

### *Recent Budget measure for third-party data*

**1.16** In November 2013, the Government announced its intention to proceed with, amend or not proceed with, a large number of announced but unlegislated taxation and superannuation measures, including a number relating to CGT. A CGT measure that is proceeding, and that will affect individual and small business taxpayers, is the 2013–14 Budget measure for *Tax compliance—improving compliance through third-party reporting and data matching*. This measure is designed to improve compliance and increase taxation revenue by expanding the ATO's ability to match the data provided by third-parties, in relation to for example the sale of real property, shares and units in managed funds. Subsequently, the Government announced in May 2014 that there would be a two-year deferral of the legislative elements of the measure from 1 July 2014 to 1 July 2016, following feedback from stakeholder consultations. The ATO

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56 The review of *Australia's future tax system*, December 2009, (also known as the Henry Tax Review) contained three recommendations that addressed CGT including recommending that the CGT system be simplified.

considers that its ability to detect and treat the risks associated with CGT will be improved through these measures.<sup>57</sup>

**1.17** Another aim of the 2013–14 Budget measure for third-party reporting and data matching is to assist the ATO to improve the pre-filling of tax returns, which would make it simpler for taxpayers who want to comply with their CGT obligations and prompt those who need encouragement to do so.<sup>58</sup>

## ATO reforms

**1.18** In recent years, the ATO has commenced an organisation-wide change program. The Reinventing the ATO program is supported by a vision for 2020 that the ATO will be: ‘a leading taxation and superannuation administration known for our contemporary service, expertise and integrity’.<sup>59</sup> One of the key concepts underpinning the Reinventing the ATO program is designing a taxation system for the majority of taxpayers who do the right thing. The ATO intends to reward taxpayers’ openness, transparency and willingness to participate in the taxation system by requiring less effort to comply (referred to by the ATO as a ‘no touch’ or ‘light touch’ approach) and increasing taxpayers’ certainty about the status of their taxation matters.

## Tax discussion paper—*Re:think*

**1.19** As part of its 2014–15 Budget strategy and priorities, the Government announced the development of a White Paper on the reform of Australia's tax system, which is designed to provide a longer-term approach to tax reform.<sup>60</sup> One of the key issues for the White Paper is the competitiveness of Australia's tax system, particularly corporate tax and new domestic and foreign investment. A task force was established in the Department of the Treasury (the Treasury) to support the development process. The Treasury and the ATO jointly undertake

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57 The ATO noted that there are challenges and uncertainty for the ATO in implementing these measures, as these areas of work cross ATO BSLs, potentially involve future legislative amendments, and require ongoing liaison with, and action by, the Department of the Treasury. The ATO advised that the risks are being managed, including through the operation of an appropriately skilled project team designated to support the implementation of the measure.

58 For example, the ATO expects that approximately 900 000 taxpayers that invest in real property will have relevant data pre-filled in their returns.

59 Commissioner of Taxation, *Reinventing the ATO*, speech delivered at the Tax Institute of Australia 29<sup>th</sup> National Convention, Hobart, 27 March 2014.

60 Australian Government, *Budget Overview: Towards a functioning Federation, 2014–15*, [Internet], 2014, available from <[http://budget.gov.au/2014-15/content/overview/html/overview\\_07.htm](http://budget.gov.au/2014-15/content/overview/html/overview_07.htm)> [accessed 19 February 2015].

activities to improve the ongoing design of tax and superannuation laws. As part of the process for developing the White Paper, a tax discussion paper—*Re:think*—was published in March 2015 that includes references to CGT.<sup>61</sup> The future White Paper could include a discussion of the CGT system and the potential for reforms that would simplify the system.

## Previous ANAO audit

**1.20** The Australian National Audit Office (ANAO) examined the ATO's administration of CGT eight years ago—Audit Report No.16 2006–07 *Administration of Capital Gains Tax in the Individuals Market Segment*. The focus of the audit was the ATO's administration of compliance by individuals with respect to the two most common CGT events: real property and share disposals. The audit concluded that the ATO's administration of CGT for that market was effective. The audit made seven recommendations aimed at improving the ATO's administration of CGT for individuals in the areas of: CGT project planning; data management and risk assessment; and compliance planning. The ATO agreed to all recommendations (see Appendix 2).

## Audit objective, criteria, scope and methodology

### Audit objective

**1.21** The objective of the audit was to assess the effectiveness of the Australian Taxation Office's administration of capital gains tax for individual and small business taxpayers.

### Audit criteria and scope

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

- management arrangements support the effective administration of CGT for individual and small business taxpayers;
- compliance risks are assessed and a coherent strategy is in place to promote compliance with CGT requirements; and
- compliance activities are appropriate and effective.

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61 The discussion paper is available on the Internet from <<http://bettertax.gov.au/publications/discussion-paper/>> [accessed 30 March 2015].

**1.23** The ANAO focussed on CGT work undertaken in the Small Business and Individual Taxpayers Business and Service Line.<sup>62</sup> The audit also includes a review of the implementation status of the seven recommendations from the 2006–07 ANAO audit report.

## **Methodology**

**1.24** In conducting the audit, the ANAO reviewed relevant documentation and interviewed key staff at a number of ATO offices. The ANAO consulted a range of stakeholders, including taxpayer representatives and tax professional bodies, providers of third-party data and staff from the Treasury.

**1.25** The ANAO analysed the data matching activities that support the ATO's CGT risk assessments and compliance work and sampled 472 CGT compliance cases in the individual and small business markets.

**1.26** The audit has been conducted in accordance with the ANAO's auditing standards at a cost of approximately \$547 000.

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62 This audit focused on individual and small business taxpayers as these market segments paid the large majority of capital gains, and had some synergies as they were administered in the same business line. It did not cover large corporate taxpayers, as the capital gains events and administration were quite different, and these taxpayers contributed a relatively small share of CGT.

## Structure of the report

1.27 Table 1.2 outlines the structure of the remaining five chapters.

**Table 1.2: Structure of the report**

Chapter		Overview
2	Management Arrangements	Examines the management arrangements supporting the administration of capital gains tax for individual and small business taxpayers, including performance monitoring and reporting on revenue.
3	Managing Compliance Risks	Examines the ATO's identification and management of capital gains tax compliance risks for individual and small business taxpayers.
4	Selecting Cases for Compliance Activity	Examines the ATO's case selection processes for capital gains tax compliance activity in relation to individual and small business taxpayers.
5	Encouraging Voluntary Compliance	Examines the ATO's activities to promote voluntary compliance with capital gains tax obligations by individual and small business taxpayers.
6	Conducting Compliance Activities	Examines the ATO's activities to address non-compliance by individual and small business taxpayers that do not comply with their capital gains tax obligations.

## 2 Management Arrangements

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*This chapter examines the management arrangements supporting the administration of capital gains tax for individual and small business taxpayers, including performance monitoring and reporting on revenue.*

### Introduction

**2.1** As previously noted, the Second Commissioner for the Compliance Group has overall responsibility for the administration of CGT. Within the Group a number of operational BSLs have responsibility for discrete market segments, particularly: Public Groups and International (PG&I); Private Groups and High Wealth Individuals (PGH); and Small Business and Individual Taxpayers (SB/IT).

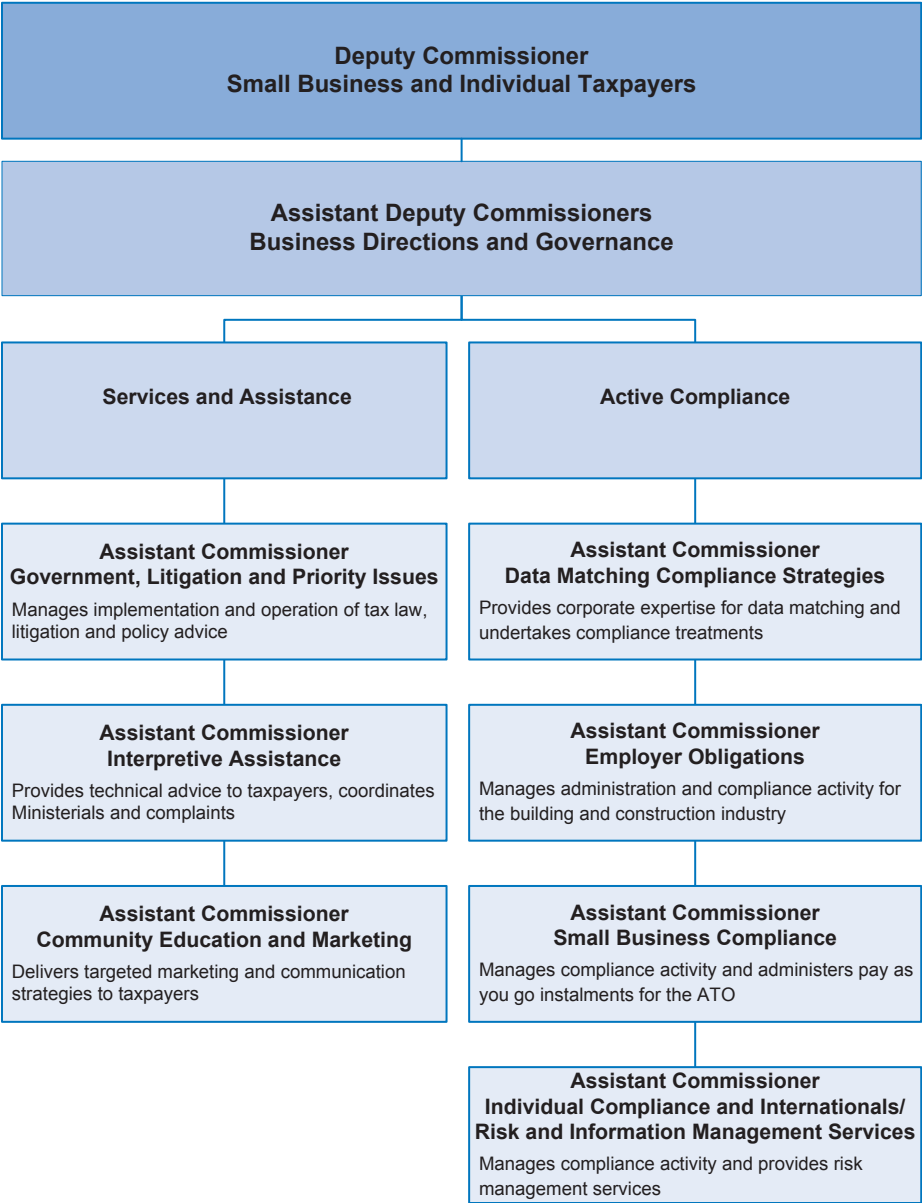
**2.2** While other BSLs in the group have a business interest in CGT, the ANAO primarily focussed on examining the management arrangements in SB/IT for CGT, including:

- its organisational structure;
- planning arrangements;
- performance monitoring and reporting; and
- complaint handling and taxpayer feedback.

### Small Business and Individual Taxpayers Business and Service Line organisational structure

**2.3** At the beginning of 2014–15, SB/IT had 2077 full-time equivalent (FTE) staff located across Australia and the BSL received a budget allocation of \$173.1 million. An overview of SB/IT's organisation structure is provided in Figure 2.1 and outlines the seven administrative streams, which are each managed by an Assistant Commissioner. An annual SB/IT Line Plan is developed to support the delivery of ATO corporate activities and programs and is underpinned by further detailed plans at the stream and local team level.

**Figure 2.1: Small Business and Individual Taxpayers Business and Service Line organisational structure**



Source: ANAO analysis of ATO data.

**2.4** Two streams undertake compliance activity for CGT—Data Matching Compliance Strategies (DMCS) and Small Business Compliance (SBC). In 2014, DMCS had an average FTE staffing level of 350 officers and a total actual budget of \$29.9 million. SBC had an average FTE staffing level of 126 officers and a total

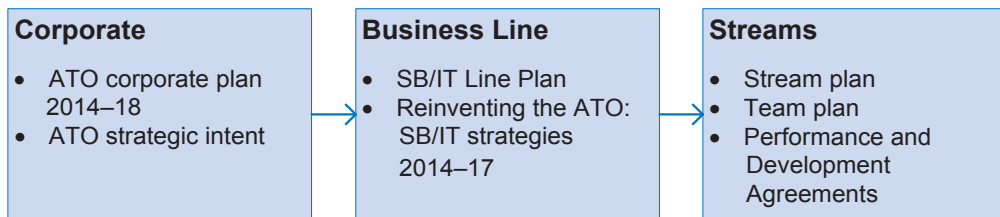


actual budget of \$13.5 million. These organisational arrangements clearly outline responsibilities for CGT compliance strategies and activities, and also support broader administrative arrangements for the tax, such as providing interpretative assistance and risk management services.

## Planning arrangements

**2.5** In 2014–15, business planning, performance monitoring and reporting are linked activities in SB/IT. Figure 2.2 identifies the main documents required to support the top down planning process for SB/IT. In particular, the *ATO corporate plan 2014–18* includes the ATO's priorities for 2014–15 and sets out its future plans.<sup>63</sup> The SB/IT Line Plan identifies the key priorities, and high-level strategies and activities for the BSL that contribute to achieving the priorities in the corporate plan.<sup>64</sup>

**Figure 2.2: Small Business and Individual Taxpayers Business and Service Line planning framework 2014–15**



Source: ANAO analysis of ATO documents.

**2.6** Overall, the planning framework for SB/IT aligns with the ATO's corporate direction. The endorsed August 2014 SB/IT Line Plan provided more detailed planning at the individual stream level, including for CGT activity, but did not include final details of the financial allocations or enterprise risks.

**2.7** The 2014–15 individual team plan for DMCS outlines the team's: roles and responsibilities; focus for the year; staffing level; and deliverables, including the number of compliance cases and revenue expected to be achieved by the

<sup>63</sup> From 2015–16, Commonwealth entities are required to prepare a multi-year, forward looking corporate plan under new planning, performance and accountability requirements introduced by the *Public Governance, Performance and Accountability Act 2013*.

<sup>64</sup> Chapter 3 examines how the ATO plans for and manages CGT risks relating to individual and small business taxpayers.

team.<sup>65</sup> In SBC, the compliance plan for all work to be undertaken by the stream in 2014–15 identifies CGT activity and specifies: the type of product to be undertaken (audit); the channel (by correspondence); the case management system to be used for the audits; and the number of cases and revenue target.<sup>66</sup>

## **Previous ANAO audit planning recommendation**

**2.8** The 2006–07 ANAO audit examined the planning process for a four-year CGT project that commenced in July 2004 and focused on capital gains arising from real property and share disposals in the individuals market segment. The ANAO recommended that CGT project planning be improved at the operational level, including by preparing an annual delivery plan and linking relevant planning documents from across the operational streams.<sup>67</sup> The ATO agreed with the recommendation and advised that it was completed in October 2007 (see Appendix 2 for details of Recommendation No.1). The CGT project has been replaced by business-as-usual administration for CGT and is supported by adequate corporate and SB/IT planning processes.

## **Performance monitoring and reporting**

**2.9** Performance monitoring and reporting systems, when aligned with the entity's outcomes and programs structure, provide information that is appropriate for internal performance management needs and external reporting requirements.<sup>68</sup> Furthermore, once budgets and revenue targets are established, regular monitoring of actual performance against approved budgets and targets is important to ensure that actual expenditure and revenue targets are in line with budget estimates.

## **Internal monitoring and reporting**

**2.10** The internal monitoring and reporting framework for SB/IT in 2014–15 is comprehensive, with reporting from the individual BSL stream level through to

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65 In 2014–15, there are two measures of success for the CGT team in DMCS: processes established to apply data matching techniques to new risks; and revenue and case numbers outcomes met (\$140 million and 10 400 cases).

66 The SBC compliance plan for 2014–15 shows that 32 CGT cases are planned and the revenue target is \$13.1 million. Revenue targets are discussed in detail at paragraph 2.16 and compliance cases for DMCS and SBC are discussed in Chapter 6.

67 ANAO Audit Report No.16 2006–07 *Administration of Capital Gains Tax Compliance in the Individuals Market Segment*, p. 14.

68 ANAO Better Practice Guide—*Public Sector Governance*, June 2014, Canberra, p. 23.

corporate reporting, including external reporting in the ATO's annual report (see paragraph 2.25).

**2.11** The SB/IT Line Plan 2014–15 contains a range of high-level performance measures for the major activities identified in the plan. While more performance measures are contained in the DMCS and SBC stream plans, those plans are also at a high-level.

**2.12** The SB/IT reporting framework includes key monthly stream and line reports—known as Heartbeat reports—that are used to monitor progress within the BSL during the year against performance measures in the Line Plan.<sup>69</sup> The Heartbeat reports also outline the progress being made towards achieving annual revenue targets and enable the SB/IT executive to monitor performance across the BSL.

**2.13** In addition, the BSL produces regular monthly and quarterly reports that are aggregated and considered by the Compliance Group and the ATO's executive management team. The focus of these reports is performance across key BSL activities, for example, interpretative assistance. The reports are by exception and highlight underperformance during the year and indicate the likely end of year result. Given the aggregation process, senior management external to the SB/IT BSL would not routinely have visibility of CGT activities, unless there was a key performance issue.

#### *SB/IT executive meetings and committees*

**2.14** In addition to reporting by stream, the coordination and monitoring of work outcomes is supported by SB/IT executive teleconferences, briefing advice from teams and monthly meetings. At a higher organisational level, CGT is discussed at meetings of the Income Tax Steering Committee. Membership of this senior management committee is drawn from all three Groups in the ATO and it is responsible for contributing to the strategic direction of income tax administration (including pay as you go withholding and instalments, CGT and fringe benefits tax). In July 2014, representatives from SB/IT were present when

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<sup>69</sup> The Line Plan contains 27 measures in the following areas of performance and accountability: working across government and internationally (four); fostering willing participation (10); addressing non-compliance (three); resolving disputes (five); and management and accountability (five). Separate performance measures are included for administered programmes.

the committee discussed the 2014 CGT Health of the System Assessment (HOTSA).<sup>70</sup>

**2.15** Prior to June 2013, the ATO had convened for many years a National Tax Liaison Group Losses and CGT Sub-committee that acted as a consultative forum and was attended by ATO officials and tax practitioners.<sup>71</sup> At its final meeting, the sub-committee considered items such as the small business CGT retirement exemption and a CGT and losses compliance report.<sup>72</sup> The 2014 CGT HOTSA refers to the closure of the sub-committee and the: ‘potential loss of forum to discuss CGT specific issues unless deemed a “big tax” issue facing Australia’.<sup>73</sup>

### *Revenue targets*

**2.16** The Treasury is responsible for preparing the Government’s taxation revenue forecasts, while the ATO is the Government’s principal revenue collection entity. According to a recent Treasury review<sup>74</sup>, the methodology it uses for revenue forecasting is similar to comparable official agencies overseas. The ATO contributes to revenue forecasting as a reviewer of the Treasury’s revenue forecasts and by undertaking business liaison with entities to supplement the modelling used for forecasting. It is important therefore that the ATO’s own revenue collection targets for compliance activities are appropriate, including achieving a balance across the full range of compliance risks and delivering a reasonable return on investment.

**2.17** Compliance Group BSLs directly contribute to achieving the ATO’s overall revenue target each year from active compliance cases.<sup>75</sup> In SB/IT, annual revenue targets for each stream are set by the SB/IT executive and the respective

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70 The HOTSA is designed to support the review of significant or emerging risks, and provides an annual checkpoint for the risk management cycle.

71 As a result of an ATO review of its external consultation arrangements, the sub-committee was replaced by a new consultation framework that started on 1 July 2013.

72 The sub-committee meeting minutes from June 2013 are published on the ATO’s website, available from <<https://www.ato.gov.au/Tax-professionals/Consultation--Tax-practitioners/In-detail/Other-forums/Losses-and-CGT/NTLG-Losses-and-CGT-Sub-committee-minutes.-June-2013/>> [accessed 23 October 2014].

73 ATO, *2014 CGT: Income Tax HOTSA*, Key Issue No.3. Community confidence, p. 1.

74 The Treasury, *Review of Treasury Macroeconomic and Revenue Forecasting*, Canberra, 2013.

75 SB/IT reporting on CGT revenue is based on liabilities raised from active compliance cases, rather than the amount of cash collected. As discussed in Chapter 6, the proportion of cash collected from liabilities raised is quite low for SB/IT CGT cases.

Assistant Commissioners determine the revenue targets for DMCS and SBC.<sup>76</sup> In both streams, CGT is one component of the work undertaken and there are a range of factors taken into account when allocating team budgets and staffing. These factors include a requirement to effectively manage ongoing risks in the CGT system within the respective market segments, and to efficiently resource compliance case teams to achieve revenue targets.<sup>77</sup> Therefore, while the maintenance of a compliance program for CGT is essential, the ATO advised that the setting of CGT revenue targets is discretionary and judgement is informed by past experience and performance outcomes from finalised cases.

**2.18** Table 2.1 shows the revenue targets and total revenue achieved for 2012–13 and 2013–14, and the 2014–15 target and revenue collected to date from compliance activities in SB/IT.

**Table 2.1: Capital gains tax revenue from compliance activities for individual and small business taxpayers, 2012–13 to 2014–15**

Taxpayer	2012–13		2013–14		2014–15	
	Individual	Small business	Individual	Small business	Individual	Small business
Original revenue target (\$ million)	250.0	65.0	133.0	50.0	140.0	13.1
<b>Total revenue (\$ million)</b>	203.9	54.2	104.7	30.3	138.0 <sup>1</sup>	18.3 <sup>1</sup>
Proportion of revenue target met	82%	83%	79%	61%	NA <sup>2</sup>	NA <sup>2</sup>

Source: Internal data provided by the ATO.

Note 1: Revenue as at the end of May 2015.

Note 2: NA is not applicable, as the year had not been completed.

<sup>76</sup> The calculation of the number of active compliance cases required to achieve the revenue target includes the consideration of prior years' cases completed, strike rates and averages. The strike rate is a measure of the ratio of audits that reached a financial outcome divided by the total number of audits finalised in the relevant period, that is, where a liability has been raised.

<sup>77</sup> In SBC, CGT risks are also addressed as a component of comprehensive audits of small businesses.

**2.19** The ATO advised that a number of factors had contributed to the decrease in revenue targets for individual taxpayers in 2012–13 and 2013–14. These included:

- The same team is responsible for CGT and partnerships, trusts and units compliance case activity and reports against a single (aggregated) target. At the team level, the revenue target has been redistributed during the period away from predominantly CGT revenue to a more equal allocation between the two areas. This redistribution reflects the ATO's increased understanding of the size of the partnerships, trusts and units risk and the need to ensure adequate coverage of both risks.<sup>78</sup>
- The introduction of a designated CGT case selection team and manual profiling process (see Chapter 4), to improve the selection of compliance cases, affected the CGT component of the team's work as efforts were made to improve the outcomes from CGT compliance activity.

**2.20** As outlined in Table 2.1, the original CGT revenue targets in DMCS and SBC were not met for the last two years and the total revenue achieved ranged from 61 per cent to 83 per cent of the target.<sup>79</sup> The ATO advised that, at the end of May 2015, the revenue achieved to date for the 2014–15 financial year from individual taxpayers was \$138 million (99 per cent of the target<sup>80</sup>) and for small businesses, \$18.3 million (140 per cent of the target). As discussed in Chapter 6, final revenue amounts for compliance activity are subject to the outcome of taxpayer objections to tax assessments and/or debt management processes that can spread payments across income years.

**2.21** The ATO advised that a number of factors contributed to the reduction in CGT revenue targets for small businesses and the total revenue collected for the same two-year period:

- until recently, the revenue from compliance activity for CGT small business concessions was considered quite high by SBC. The separation

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78 The original team level revenue target, for CGT and partnerships, trusts and units combined, increased from 2013–14 (\$210 million) to 2014–15 (\$240 million).

79 Following mid-year reviews, the DMCS targets were reduced and the total revenue achieved was 88 per cent and 87 per cent respectively of the revised targets. Similarly, for SBC, following a reduction in the revenue target for 2012–13, the total revenue achieved that year increased by two per cent to 85 per cent.

80 In April 2015, the ATO advised that the 2014–15 revenue target for DMCS was not revised at a mid-year review in December 2014 and DMCS expected to meet the revenue target by the end of the financial year.

of that work between SBC and the Wealthy Australians program in PGH resulted in a gradual decline in CGT revenue.<sup>81</sup> Accordingly, SBC changed its focus in 2014–15 to treat an expanded range of risks in the small business market and also included CGT as a component of its comprehensive audit program for small businesses; and

- a reduction in the overall number of compliance staff in SBC from 2012–13 to 2014–15, and change in the profile of operational staff—a 61 per cent increase in Australian Public Service (APS) level 4 staff, and a 32 per cent decrease in APS5 and APS6 staff—reduced the number of CGT-specific compliance cases able to be completed in each financial year. Most CGT small business concession work was undertaken by APS5 and APS6 senior level staff.

**2.22** The 2006–07 ANAO audit found that, for the ATO's annual *Compliance Programs* from 2002–03 to 2005–06, the ATO consistently met or exceeded its CGT coverage commitments for the individuals market.<sup>82</sup> By comparison, in the three most recent years shown in Table 2.1, there has been a significant reduction in the revenue targets for CGT compliance activity. These reductions are partially explained by BSL and stream reorganisations of work functions to accommodate changes in risk in the individual and small business market segments. In this regard, the ATO advised that SB/IT staff reductions have been offset by advancements in technology and improved work practices, which support BSL revenue commitments. However, benefits from these advancements and work practices are yet to be demonstrated or quantified. DMCS is also anticipating that the implementation of the 2013–14 Budget measure designed to improve third-party data matching will positively impact on its CGT operations. In the future, the ATO expects further changes in resourcing and skilling to affect its approach to compliance work as the Reinventing the ATO program is implemented.

Previous ANAO audit recommendation for revenue targets

**2.23** When examining CGT active compliance planning in the individual taxpayer market segment, the previous ANAO audit identified a range of issues

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81 One of the functions transferred was small business concessions, the largest CGT risk for the small business market. The SBC stream still expects to undertake limited compliance activity for small business concessions in 2014–15, as part of its 32 CGT audit and review cases.

82 ANAO Audit Report No.16 2006–07 *Administration of Capital Gains Tax Compliance in the Individuals Market Segment*, p. 77.



around targets for liabilities and the application of cash collection rates.<sup>83</sup> The ANAO recommended that, to inform future compliance planning, the ATO determine and document its methodology for setting the CGT project liabilities and cash collection targets, and consistently apply the cash collection rate to liabilities raised. The ATO agreed with the recommendation and advised that it was implemented in October 2007 with the preparation of: various plans setting out a process to estimate project liabilities; and a cash collection methodology developed by the ATO's Revenue Analysis Branch (see Appendix 2 for details of Recommendation No.7).

**2.24** The ATO's current *Active Compliance Collection Rate Method 2013–14* is used to determine collection rates on active compliance work undertaken by the ATO and to inform individual BSL planning, which includes details of CGT compliance activities in SB/IT.<sup>84</sup> The methodology is documented and routinely applied to compliance activities, which provides a greater degree of certainty for SB/IT when setting revenue targets as to how cash collection amounts will be calculated. Notwithstanding this methodology, the prime focus in SB/IT in monitoring and managing revenue from CGT compliance activities has been on liabilities raised, with much less attention given to cash collected.

## External reporting

### *Portfolio Budget Statements and annual report*

**2.25** The ATO's program objectives, deliverables and key performance indicators are published annually in the Treasury's Portfolio Budget Statements (PBS). The PBS does not make any reference to CGT, which forms part of income tax. Correspondingly, the ATO's annual report for 2013–14 makes only limited references to CGT matters.<sup>85</sup>

### *Taxation statistics for CGT*

**2.26** While there is limited reporting on CGT in its annual reports, the ATO produces yearly taxation statistics on its website. An annual publication, *Taxation statistics*, summarises statistical information from taxpayers, primarily from income tax returns and including CGT schedules.<sup>86</sup> The schedules contain

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83 *ibid.*, pp. 76–80.

84 Chapter 6 discusses the liabilities raised and cash collected for individual taxpayers in more detail.

85 One reference to CGT is as an area of concern due to the incorrect application of CGT provisions by wealthy individuals and their businesses. ATO, *Annual Report 2013–14*, p. 58.

86 ATO, *Taxation statistics* [Internet], 2014, available from <<https://www.ato.gov.au/About-ATO/Research-and-statistics/Taxation-statistics/>> [accessed 24 October 2014].



information about the value of capital gains and losses from CGT assets and events and CGT concessions for small businesses.

**2.27** There are also a number of CGT specific data sets<sup>87</sup> available on the ATO's website and the data is also available from the Australian Government's data.gov.au website. The main purpose of that website is to encourage public access to and reuse of government data by providing it in useful formats under open licences.<sup>88</sup> The ATO makes available CGT data that is public, timely and accessible.

## Complaint handling and taxpayer feedback

**2.28** The management of complaints and other feedback should form part of the monitoring and reporting of an entity's performance and can be used to make improvements in service delivery for the community. The ATO has established procedures for the management of complaints and other feedback. While a centralised team oversees complaints management, the resolution of complaints is devolved to BSLs.<sup>89</sup> Table 2.2 shows the CGT related complaints and other feedback received by the DMCS and SBC streams for individual and small business taxpayers from 2011–12 to 2013–14.

**Table 2.2: Small Business and Individual Taxpayers Business and Service Line capital gains tax related complaints and other feedback, 2011–12 to 2013–14**

Type of receipt recorded	Individuals	Small business
Complaints	47	5
Compliments	0	0
Feedback	0	0
Queries to members of parliament <sup>1</sup>	8	0
Ministerials	17	0
<b>Total receipts</b>	<b>72</b>	<b>5</b>

Source: ATO.

Note 1: Each BSL has a direct phone number for federal members of parliament to contact the ATO with constituent enquiries or issues.

87 These data sets include, for a range of income years, data for: selected CGT schedule items; net capital gains subject to tax, by entity type; and net capital gains, by entity type, taxable status and amount of gains.

88 The website was created following the Government's Declaration of Open Government and response to the Government 2.0 Taskforce report. Available from <<https://data.gov.au/>> [accessed 24 October 2014].

89 In 2014, an ANAO audit of the management of complaints and other feedback in the ATO concluded that the ATO's complaints handling framework was well-designed and its management arrangements generally sound. ANAO Audit Report No.19 2013–14 *Management of Complaints and Other Feedback*, p. 14.

**2.29** For the three-year period shown in Table 2.2, a total of 52 complaints relating to CGT were received from individual and small business taxpayers and 25 inquiries from individual taxpayers. By comparison, in 2013–14, the ATO received approximately 23 900 complaints in one year.<sup>90</sup> The ANAO examined the records for approximately one third of the total feedback cases (28) and found that the most frequent topics raised by taxpayers were main residence exemptions (13) and other property related matters (eight). Only two inquiries related to share transactions.<sup>91</sup> Overall, SB/IT recorded a comparatively low number of complaints about CGT, and most complaints were from individual taxpayers, who are contacted in much greater numbers each year by DMCS compared to SBC contact with small businesses (see Chapter 6).

## Conclusion

**2.30** Appropriate management arrangements are in place in the SB/IT BSL to support the administration of CGT for individual and small business taxpayers. In 2014–15, the high-level planning framework for SB/IT aligns with the ATO's corporate direction and supports the more detailed planning for CGT that occurs at the stream and team levels. Business planning and performance monitoring and reporting are linked activities in SB/IT and are supported by a number of corporate and BSL reports, although routine CGT activities are not monitored and reported to senior management.

**2.31** In DMCS and SBC, there were significant decreases in the specific revenue targets for CGT for individual taxpayers (in the last two years) and small business taxpayers (in the last three years), which related in part to changes in the composition of revenue targets at the team level and the reallocation of staff and work to other areas of the ATO. While a level of compliance activity was maintained, neither market segment exceeded 85 per cent of its original revenue target in a single year.

**2.32** There is considerable uncertainty about future CGT compliance activity for individual and small business taxpayers as: revenue targets continue to fluctuate for both market segments; the number of CGT specific review and audit cases in 2014–15 reduced considerably in SBC and the benefits of

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90 ATO, *Annual Report 2013–14*, ATO, Canberra 2014, p. 95.

91 The ANAO reviewed the ATO's process for recording and managing complaints and other feedback, but did not assess in detail SB/IT's compliance with individual steps in the process for resolving complaints or responding to correspondence and phone calls from taxpayers.

incorporating CGT cases into the broader small business compliance program are yet to be confirmed; and uncertainty remains about the timing and impact on CGT compliance activity outcomes for individual taxpayers in relation to the implementation of the 2013–14 Budget measure.

## 3. Managing Compliance Risks

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*This chapter examines the ATO's identification and management of capital gains tax compliance risks for individual and small business taxpayers.*

### Introduction

**3.1** Central to the ATO's conduct of compliance activities is the identification and management of risk. A sound analysis of the likelihood and consequences of risks enables risk managers to make informed decisions about risk mitigation strategies. It also enables the ATO to direct resources towards those taxpayers who do not comply with their CGT obligations.

**3.2** The ATO has an Enterprise Risk Management Framework to support the broad management of risk across all taxpayer groups and market segments. There are also specific processes in SB/IT for managing CGT compliance risks for individual and small business taxpayers.

**3.3** To assess the ATO's management of CGT compliance risks for individual and small business taxpayers, the ANAO examined:

- the coverage of these risks within the ATO's corporate risk planning arrangements;
- DMCS' and SBC's risk management processes; and
- the implementation of the previous ANAO audit recommendations relating to CGT compliance risks in the individuals market segment.

### Corporate risk planning

**3.4** The ATO's risk management policy sets out the responsibilities of staff in relation to risk management and includes guidelines to support the policy's application.<sup>92</sup> The ATO manages risk at three levels; enterprise, operational, and tactical.

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92 ATO, *Risk Management Policy*, Chief Executive Instruction, March 2015.

## Enterprise Risk Manager

**3.5** The ATO uses an Enterprise Risk Management Framework<sup>93</sup> to support its management of risk. A fundamental component of this framework is an ATO-wide risk register—the Enterprise Risk Manager (ERM). The ERM records enterprise and operating level risks as soon as practicable after they are identified and assessed (risk rated). The ERM also has the capacity to store supporting documentation such as risk assessments, treatment plans and reviews.

**3.6** In 2014–15, the ATO identified seven separate CGT risks in the ERM.<sup>94</sup> Since June 2014, the CGT enterprise risk owner (based in PG&I) has been overseeing a review aimed at consolidating those risks into a single CGT risk description and risk assessment in the ERM.<sup>95</sup> The ATO has been moving towards a more holistic approach to CGT aimed at reducing the existing potential for duplication of effort in risk management by individual BSLs.<sup>96</sup>

**3.7** In SB/IT, CGT is identified for both individual and small business taxpayers as an operational level risk that is ongoing, whereby there is a continual risk of taxpayers failing to understand and meet their CGT obligations. The CGT risk has been rated as ‘high’ for both markets, which is a combination of the consequence rating (risk to revenue and reputation, and impact on voluntary compliance) and the likelihood rating (either the frequency of issues in the risk population or probability of the risk occurring).

**3.8** The high risk rating is based on a number of factors (such as taxpayers’ lack of understanding of their obligations, including the need to retain detailed records, and complexity of the law), and indicates the need for ongoing compliance activity for the CGT risk. The rating is also consistent with the findings from this audit. While the audit identifies factors presently beyond the

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93 The ATO’s Enterprise Risk Management Framework incorporates AS/NZS ISO 31000:2009, *Risk management—Principles and guidelines*. The International Standard provides principles and generic guidelines on risk management.

94 The seven risks are: CGT small business concessions; CGT incorrect reporting PG&I; CGT capital losses PG&I; CGT capital losses PGH; CGT micro enterprises SB/IT; CGT individuals; and CGT non-residents Division 855 (of the *Income Tax Assessment Act 1997* relating to capital gains and foreign residents).

95 Historically, the majority of CGT specialists were located in the former BSL for Large Business and International Markets, and the current enterprise risk owner for CGT is located in PG&I.

96 The ATO advised in May 2015 that a new risk assessment for CGT had been endorsed. The market segments covered by the risk assessment are: large businesses; small-medium and micro enterprises; and individuals. The rating for the new (combined) CGT risk is ‘significant’, which is a lower rating than that assigned individually to the two market segments in SB/IT.

ATO's control (such as the usefulness of third-party data for CGT compliance activities with individual taxpayers), it also raises issues about factors within its control (such as improving the effectiveness of CGT compliance activities for individual taxpayers and the scale of specific CGT active compliance for small business taxpayers).

## **Health of the System Assessment**

**3.9** The Health of the System Assessment (HOTSA) update is part of the ATO's formal annual planning process. The HOTSA is designed to support the review of significant or emerging risks, and provides an annual checkpoint for the risk management cycle. In assessing the risks of taxpayers not complying with the CGT system as part of the HOTSA process, the ATO draws on a range of information sources, including: stakeholder surveys; results from compliance activity; and internal research, data and trend analysis based on data from income tax returns and third-party external data providers.

**3.10** The HOTSA summary of key issues for CGT comprises 12 elements, with accompanying ratings. In July 2014, the HOTSA identified eight of these system elements as being green (basically sound), and four as amber (not fully healthy). The challenges involved with improving third-party data and reporting are identified throughout the HOTSA, including for effective and sustainable design.

**3.11** The green ratings in the HOTSA, for CGT outcomes<sup>97</sup> have the potential to give rise to a level of complacency among the ATO's senior executive about the operation of the CGT system that is not supported by the ongoing presence of a high risk rating in the individuals and small business market segments. Given the nature of corporate reporting in the ATO (discussed in paragraph 2.13), senior management would not routinely have visibility of the CGT activities conducted in the SB/IT BSL. A business-as-usual approach over time could also have contributed to the relatively slow improvements to data matching arrangements (discussed in Chapter 4) and a lack of recent evaluations of the effectiveness of voluntary compliance activities for individual taxpayers (discussed in Chapter 5).<sup>98</sup>

**3.12** The 2014 HOTSA outlined areas of the CGT system that remain of concern (an amber rating) to the ATO. These include: effective and sustainable

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97 The remaining system elements are classified as either 'operating' or 'administrative design' features.

98 Voluntary compliance activities include coordinated marketing, communication and education activities targeting specific taxpayers.

design; the cost to operate the system; and ATO internal capability. The ATO describes the design of the CGT system as mechanical, rather than principal-based legislation, owing to the 53 different CGT events specified in the legislation. This can lead to a fragmented approach to legislative change over time that increases the challenges for the ATO to effectively administer CGT.<sup>99</sup> One way the ATO is responding to the challenges for sustainable design is by identifying opportunities to improve legislative design, including through involvement with the Treasury in the development of a Tax White Paper.

**3.13** The cost to operate the CGT system, particularly for taxpayers, is of concern to the ATO. For taxpayers, the requirements for complying with CGT can add substantially to the cost of managing their tax affairs. Record keeping can be more extensive for CGT purposes due to both the extent and length of time records are required to be retained for CGT events.<sup>100</sup> In 2014–15, the ATO's focus on voluntary compliance activities is intended to support taxpayers by engaging earlier and informing them about their CGT obligations prior to their lodging an income tax return. The ATO expects these activities to reduce costs for taxpayers.

*Internal capability gaps: skills and compliance staff reductions*

**3.14** Lack of knowledge about specific CGT compliance issues was identified in the 2014 HOTSA for those staff undertaking CGT compliance activity in SB/IT, PGH and PG&I. The ATO advised that it intends to address this capability gap through targeted CGT courses and e-learning modules as well as clearly identifying training needs in team members' performance development agreements.

**3.15** While it is common for skills to be learned in the workplace, CGT training is compulsory for technical staff in SB/IT and PGH with e-learning being the most common delivery mechanism. The ATO's records show that from March 2011 to September 2014, 626 CGT e-learning courses were completed or accessed by SB/IT staff working with individual taxpayers and small businesses, including external staff (contractors). SBC compliance staff reported: receiving training on-the-job and on site, including visits from trainers;

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99 For example, as part of the CGT system, some provisions require a market valuation, which can be a substantial cost and potentially prohibitive for smaller taxpayers. Stakeholders contacted by the ANAO during the audit identified the cost of valuations for CGT purposes as an issue, especially for small businesses.

100 In particular, evidence of an original loss must be retained for capital losses to be carried forward.



and having access to local technical advice. Those same staff expected to undertake CGT refresher courses in the future. Other SB/IT staff, also involved in administering CGT, identified that mentoring arrangements and e-learning courses were available to support team members.

**3.16** At the beginning of 2014–15, SB/IT was subject to a number of structural changes affecting its administration of CGT, particularly a transfer of functions and workforce from SB/IT to PGH, to consolidate management of the Wealthy Australians program from 1 July 2014. The ATO advised that: ‘overall the reduction in staff has been offset by advancements in technology and work practices which have allowed SB/IT to deliver on its revenue commitments to government’.

**3.17** While there has been an impact in 2014–15 on work roles and a reduction in the SBC compliance staffing numbers of 17 per cent (from 101 FTE in 2013–14 to 84 FTE in 2014–15), it was too early for this audit to determine the extent of any skills or experience gap in the administration of CGT. However, with less specialist knowledge available in the stream, and a significant reduction in staffing numbers, considerable improvements in staff capability and business processes will be needed to ensure that CGT active compliance interventions are effective. Accordingly, it will be important for the ATO to provide training and support for staff conducting small business CGT compliance activities.

## **Managing CGT risks within the Small Business and Individual Taxpayers Business and Service Line**

**3.18** The implementation of CGT risk management in DMCS and SBC is the responsibility of the risk owner (Assistant Commissioner) and the risk managers are responsible for monitoring activities at the operational level.

**3.19** As previously noted, the processes for managing CGT compliance risks in SB/IT are supported by a series of documents retained in the ATO’s Enterprise Risk Manager system. To help ensure consistency, these documents are to be completed by BSLs using corporate templates. The minimum set of documents required to support the ATO’s risk management process are a:

- risk assessment—detailed information about the risk, including its drivers, the risk event itself, the consequences and likelihood of the risk and how the level of risk was determined;
- risk treatment plan—detailed information about treatments that can be put in place to reduce the consequence and likelihood of the risk; and



- risk review—evaluates the current status of a risk and whether existing controls and/or treatments are appropriate.

**3.20** As part of the risk treatment plan, BSL's can also complete additional supporting documentation such as a:

- target selection rationale—describes the method and reason for selecting the target population; and
- treatment evaluation—reports the effectiveness of the treatment strategy in relation to the desired outcomes and compliance behaviours.

**3.21** Table 3.1 outlines the SB/IT documentation that supports the risk management process for CGT from 2010 to 2014. DMCS prepared the minimum required set of risk documents over the period, while SBC prepared target selection rationales and treatment evaluations, in addition to the standard documents.

**Table 3.1: Small Business and Individual Taxpayers Business and Service Line risk documentation for managing capital gains tax risks, 2010 to 2014**

Risk process documents	DMSC: Individuals	SBC: Small business
Risk assessment	September 2012	May 2011
Risk treatment plan	September 2012	March 2013 September 2013
Target selection rationale <sup>1</sup>	No documentation	December 2010 (draft) July 2012 (two documents) October 2012 May 2013 (draft)
Treatment evaluation <sup>1</sup>	No documentation	March 2011 (interim) August 2013 (draft) November 2013 (draft)
Risk review	February 2014	March 2013 March 2014

Source: ANAO analysis of ATO documents.

Note 1: Preparation of these documents is optional.

**3.22** The following sections discuss DMCS' and SBC's differing approach to risk management and the impact on managing CGT risk in their respective markets.

## Risk assessment

**3.23** The DMCS and SBC risk assessments for CGT contain similar characteristics for individual and small business taxpayers. Appendix 3 sets out the common features of both risk analyses, including identifying risk events<sup>101</sup>, risk participants (such as individuals and companies outside the tax system) and risk drivers.<sup>102</sup> Overall, the existing risk assessments are consistently documented. Modifications to risk assessments can be informed by analysis from ATO intelligence sources and the results from activities to address non-compliance by taxpayers, such as the results from corresponding with taxpayers and reviews and audits.

### *New potential risk: small business valuations*

**3.24** In January 2014, the Government announced that the Australian Valuation Office would cease to provide services by 30 June 2014.<sup>103</sup> The ATO considered that this posed a risk that it would be unable to continue the scale of compliance activity involving small business concessions as valuation advice would be more expensive or less readily available.

**3.25** The ATO is now using an internal tool (a customised spreadsheet) developed by SBC to assess maximum net asset valuations, as part of treating the small business concessions risk.<sup>104</sup> The ATO's assessments of CGT risks for small business did not however capture the change in organisational structure or reduced capacity to obtain valuations for concessions work.<sup>105</sup>

## Risk treatment and target selection

**3.26** The ATO's target selection rationale documents describe the method and reason for selecting a population that will be subject to the treatment of an

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101 Common risk events include: taxpayers incorrectly claiming concessions or exemptions and under-reporting or omitting CGT; and tax agents and other representatives failing to ask the right questions or providing incorrect advice.

102 Among the risk drivers identified for taxpayers are lack of awareness and understanding of obligations, and complexity of the law. For tax agents and other representatives, the risk drivers include not keeping up-to-date with legislation or technology, and time pressure.

103 S Ciobo, (Parliamentary Secretary to the Treasurer), 'Closure of the Australian Valuation Office', media release, Parliament House, Canberra, 24 January 2014.

104 The ATO advised that the use of this tool negates the requirement for an expert valuation before deciding whether to further test a taxpayer's valuation.

105 The March 2014 Risk Review, for SBC, recommends that a new risk assessment is required for the small business market segment.

identified risk. Therefore, there should be a close alignment between the risk treatment plan and the target selection rationale.

**3.27** The 2012 risk treatment plan for individual taxpayers with CGT obligations is consistent with the risk assessment completed at the same time. The target group in the treatment plan is individual taxpayers that have had a capital gains event. More specific target selection rationales were not documented, and the target group is a large, undifferentiated population—all individuals that have had a capital gains event. Instead of focusing on a risk treatment plan, pilot documentation is to be prepared in DMCS when a new risk or data source is identified.<sup>106</sup> In light of the strong focus of CGT compliance activity for individual taxpayers on real property transactions (as discussed in Chapter 4), developing targeted selection rationales may assist DCMS to achieve a more balanced coverage of asset types, including shares and other financial transactions that trigger a capital event.

**3.28** In contrast, detailed risk treatment plans and target selection rationales<sup>107</sup> have been developed (listed in Table 3.1) to address CGT risks for the small business market. The documentation is consistent with the risk assessments, and the target selection rationales include details of the criteria to be used for selecting taxpayer cases for compliance activity that are broadly consistent with the case selection process used for small businesses.<sup>108</sup>

## Treatment evaluation and risk review

**3.29** It is important that the risk management process includes an evaluation of how effectively the subsequent compliance activities have met those intended outcomes.

### *DMCS: individual taxpayer evaluations*

**3.30** The approach to treatment evaluation differs between the two streams. In DMCS, the absence of risk treatment plans and target selection rationales does not support a formal evaluation process. Instead, the CGT data matching

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106 For example, in 2014, DMCS documented a CGT pilot for the disposal of property rented before being occupied by the owner. Based on the pilot results, these types of cases were subsequently included in the business rules for CGT case selection (see Chapter 4).

107 In Table 3.1, the finalised target selection rationales for small business included CGT for small business concessions, company discounts and real property.

108 Case selection is discussed in Chapter 4.

program for individuals is an ongoing program of work and monitoring and evaluation activities are conducted as follows:

- feedback about taxpayer contact, data issues and the general progress of the compliance work program is provided by case identification, selection and actioning teams on a fortnightly basis to the risk manager<sup>109</sup>; and
- the potential for changes to existing business rules and requirements for matching data are reviewed as the data sets that support compliance activity are refreshed by third-party providers, either three or six monthly depending on the data provider.<sup>110</sup>

### *SBC: small business evaluations*

**3.31** The most recent treatment evaluation for small business was a draft analysis in November 2013 of the compliance activities for CGT in the 2013 financial year. The draft, which was not finalised, included: an outline of the treatment strategy; an assessment of the outcomes, including the number of cases, liabilities and revenue raised, and collection rate; and a series of draft recommendations that were not finalised for consideration by the SB/IT executive.

### *Risk reviews*

**3.32** Both DMCS and SBC risk reviews in 2014 assessed that, as there had been very little change in the risk events and participants for CGT, the overall risk rating remained 'high'.

**3.33** The DMCS risk review in February 2014 included a review of the prevailing (September 2012) risk assessment and risk treatment plans, which did not require any changes. SBC risk reviews, in March 2013 and 2014, concluded that the risk environment for CGT and small business was materially unchanged and therefore SBC should continue to develop and refine compliance activities for this market segment. However, these reviews did not address major changes to SBC compliance activities that occurred throughout 2014. As previously mentioned, these changes included an inability to obtain valuations in relation to CGT small business concessions; and reductions in staffing numbers and profiles.

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109 The ANAO reviewed agendas from meetings held in 2013 and 2014, which included standing agenda items for technical and other updates and the discussion of emerging issues.

110 The DMCS register of business rules and requirements under review in 2014 contained 40 topics with 19 having an 'open' status (as at August 2014). The application of business rules is examined in Chapter 4.

## Previous audit recommendations

**3.34** The previous ANAO audit examined the mechanisms and strategies the ATO used to identify and assess CGT compliance risks in the individuals market segment.<sup>111</sup> The ANAO made five recommendations which were agreed by the ATO and aimed at improving the administration of CGT (see Appendix 2 for Recommendation Numbers 2, 3, 4, 5 and 6 and the full ATO response). The recommendations were intended to complement the ATO's aim at the time of embedding CGT capability improvements into its business-as-usual practices.

**3.35** The recommendations covered a range of issues in the areas of: research and intelligence; data management; and identifying CGT compliance risks for compliance activities. The ANAO's assessment of the implementation status of the recommendations is provided in Appendix 2. The five compliance risk recommendations have been implemented by the ATO.

**3.36** For CGT in the individuals market, the ATO has continued to focus on acquiring third-party data from state and territory governments to support data matching activities for CGT active compliance, in particular for real property (see Chapter 4 for details). To improve data quality, in the eight years since the previous ANAO audit, the ATO:

- redesigned the CGT schedule for income tax returns in 2013, which was expected to improve the availability of CGT information for compliance activity;
- provided feedback to state and territory governments about any issues identified with the quality of the real property data being provided; and
- initiated and supported the implementation of a 2013–14 Budget measure, *Tax compliance—improving compliance through third-party reporting and data matching*. The measure, currently scheduled to commence in July 2016, is designed to improve voluntary and direct taxpayer compliance by enhancing the information reported to the ATO by a range of third parties—including the potential for reporting unique identifiers to assist with data matching activities.

**3.37** The ATO concluded negotiations with all state and territory governments for the acquisition of real property data after the previous audit.

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111 ANAO Audit Report No.16 2006–07 *Administration of Capital Gains Tax Compliance in the Individuals Market Segment*, p. 49.

This enabled the ATO to achieve national coverage for its CGT case selection and compliance activities. Further, the compliance risks for CGT unit trust distributions, for individual taxpayers, were assessed and formally documented to support compliance activity that was planned before the completion of the CGT project. These actions addressed the five ANAO recommendations, notwithstanding the substantial ongoing limitations with the use of real property and share data in the identification and selection of taxpayer cases for compliance work, as discussed in Chapter 4, and the opportunity for the ATO to improve elements of the administration of CGT within its control.

## Conclusion

**3.38** CGT risk planning is generally adequate, including the conduct of annual planning arrangements through the ERM and HOTSA processes. While the CGT risk has been rated as high for individual and small business taxpayers, there has been little change in the CGT risk profile in recent years.

**3.39** The formal management of CGT risk by the SB/IT BSL from 2010 to 2014 was in line with the ATO's corporate risk management processes. In DMCS, the minimum set of documents required to support the ATO's risk management process was prepared. The DMCS approach to CGT risk management was informal and mostly occurred as part of business-as-usual compliance operations. In contrast, SBC also prepared target selection rationales and treatment evaluations to guide operational activities for CGT compliance.

**3.40** In conducting these processes, DMCS and SBC, for the most part, appropriately identified and assessed compliance risks for both the individual and small business taxpayer markets. Emerging risks for SBC compliance activity—obtaining essential valuations for compliance cases and staffing changes that impact on the type of audit activity—are being addressed, but were not included in existing risk assessments.

**3.41** During the previous ANAO audit in 2006–07, the ANAO made five recommendations that were designed to improve compliance risk management in the individuals market. These recommendations had been adequately implemented by the ATO. DMCS has gradually increased its understanding of how to use third-party data to manage CGT risk and support compliance activities for individual taxpayers. Nevertheless, substantial limitations remain with the use of real property and share data in the identification and selection of taxpayer cases for compliance work.

## 4. Selecting Cases for Compliance Activity

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*This chapter examines the ATO's case selection processes for capital gains tax compliance activity in relation to individual and small business taxpayers.*

### Introduction

**4.1** To meet the community's expectation of a fair and equitable tax system, it is important that the ATO responds appropriately to instances of potential and actual non-compliance. The selection of taxpayer cases for compliance activity is informed by the ATO's risk assessment process, which identifies the types of risk event and likely participants. As such, there should be a close alignment between the risk treatment plan and target selection rationale that identifies the population that will be subject to compliance activity.

**4.2** The ANAO examined the ATO's case selection processes and in particular the:

- case selection processes for individual and small business taxpayers;
- use of third-party data matching for individual taxpayers; and
- future CGT case selection.

### Case selection processes

**4.3** Given the broad range of possible CGT risk events and their intermittent occurrence for most taxpayers, the CGT population is not static from year to year and specific instances of non-compliance can be difficult to detect. To identify potential non-compliance, and select cases for compliance activities, the ATO relies on an examination of CGT disclosures in tax returns, to assess the likelihood of taxpayers having omitted or understated capital gains.<sup>112</sup>

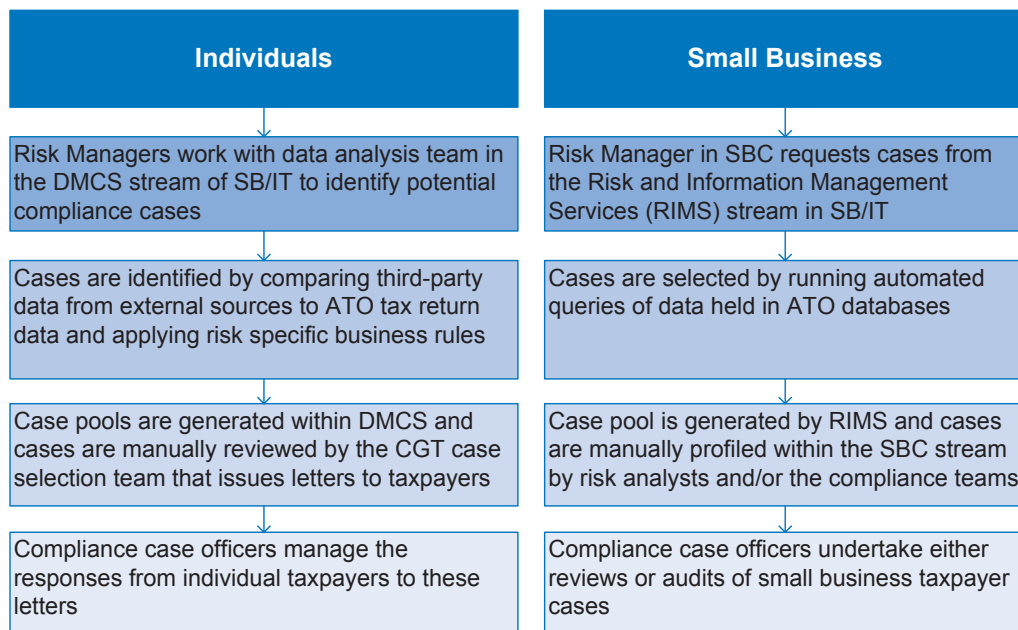
**4.4** The case selection processes for CGT compliance activities for individual and small business taxpayers are summarised in Figure 4.1.

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<sup>112</sup> The number of cases undertaken is determined by annual revenue targets for individual and small business compliance activity.



**Figure 4.1: Capital gains tax case selection process: individuals and small business**



Source: ANAO analysis of ATO documents and advice during audit fieldwork.

## Case selection differences between individual and small business taxpayer segments

**4.5** DMCS selects potential individual taxpayer cases for compliance activity through a data matching process based on business requirements, and by applying business rules for case selection as part of the data matching process outlined in Figure 4.2 (and discussed further in paragraph 4.15).<sup>113</sup> SBC staff select potential taxpayer cases for compliance activity in consultation with staff in the separate Risk and Information Management Services (RIMS) stream in SB/IT<sup>114</sup> based on its target selection rationale (discussed in Chapter 3).

**4.6** DMCS uses a high degree of automation to select cases, generating thousands of potential cases. Considerably fewer potential cases are returned to SBC from data queries undertaken by RIMS. This fundamental difference in the

<sup>113</sup> Figure 4.2 illustrates the movement of data from external third-party data providers to the ATO (data capture), and internally within the ATO's two key processes (identity matching and discrepancy matching) that support CGT compliance activity for individual taxpayers.

<sup>114</sup> RIMS provides intelligence, research, data analysis, case selection, compliance effectiveness, monitoring and risk management services.



case selection processes reflects the different compliance strategies of the two streams—DMCS has a high volume approach, whereas SBC is more targeted. As discussed in Chapter 6, 6153 CGT cases were finalised by DMCS in 2013–14 for individual taxpayers, resulting in \$104.7 million in liabilities raised. By comparison, 406 cases were finalised by SBC in 2013–14 for small business taxpayers, resulting in \$30.3 million in liabilities raised. SBC has a more traditional review and audit<sup>115</sup> approach applied to a smaller number of CGT cases.<sup>116</sup>

## Generating cases for SBC

4.7 The data extracted by RIMS and provided to SBC in relation to potential cases for small business compliance activity includes relevant information about:

- the taxpayer's business market segment;
- the taxpayer's assets, income and liabilities;
- the date the CGT schedule was received by the ATO; and
- whether a small business concession was claimed.

The RIMS output also contains information about other current compliance activities being undertaken with taxpayers so that SBC staff can seek to minimise and/or coordinate the number of separate contacts taxpayers received from the ATO at any one time.

4.8 The initial RIMS data contains thousands of taxpayer records relating to CGT.<sup>117</sup> After further review and manual profiling by SBC, the pool of potential compliance cases for small business is reduced to several hundred cases. The ATO advised that the knowledge and experience SBC staff have of the small business market, and the feedback from compliance cases, influences the data provided by RIMS and the final number of cases that are selected and proceed to a review or audit.

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115 Reviews and audits carried out by the ATO to deter taxpayers that are non-compliant with their tax obligations are more resource intensive examinations of a taxpayer's income tax affairs than bulk mailouts of letters. ATO, *How we check compliance* [Internet], ATO, available from <<https://www.ato.gov.au/General/How-we-check-compliance/>> [accessed 8 January 2015].

116 Prior to the previous ANAO audit, and the ability to undertake third-party data matching, the compliance approach for individual taxpayers was also based on reviews and audits.

117 The RIMS case related data in 2012–13 and 2013–14 was accessible in 20 separate spreadsheets.

## Manual review processes

**4.9** Both DMCS and SBC apply manual review processes when selecting from the potential pool of taxpayer cases. For DMCS, the automated data matching details are reviewed manually by staff using: ATO intelligence systems; an ATO subscription to online property databases for checking details; and Google searches and maps. Similarly, for SBC, manual profiling of potential cases can involve online property searches and subsequent Google searches and maps to locate entities. The compliance outcomes from the manual review processes, which are an indicator of their effectiveness, are discussed in detail in Chapter 6. The ATO uses the outcomes from compliance activities as an internal source of intelligence to inform treatment strategies for compliance risks.

## Data matching for individual taxpayers

**4.10** Data matching activities enable the ATO to apply computer assisted data matching processes to external data to identify people outside the tax system, non-lodgers (those who have not lodged a tax return in the recent past) or discrepancies in taxpayer information, which facilitates the detection of non-compliance. Figure 4.2 shows the role that data matching has in supporting CGT compliance for individual taxpayers in particular.

## Previous ANAO audit

**4.11** During the 2006–07 ANAO audit, the ATO advised that delays in acquiring external data meant that one State Revenue Office was the main source used to identify real property disposals for administrative action during 2005–06.<sup>118</sup> Similarly, the ATO had not finalised its acquisition of relevant share trading data from the Australian Stock Exchange and selected share registers.<sup>119</sup>

## Current arrangements with third-party data providers

**4.12** In 2014–15, the ATO is accessing real property and share data from a large number of third-party data providers to support CGT compliance activities for individual taxpayers. These data providers include: state and territory revenue offices, land titles registries, and tenancy authorities; the Australian

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118 ANAO Audit Report No.16 2006–07 *Administration of Capital Gains Tax Compliance in the Individuals Market Segment*, p. 15.

119 *ibid.*

Securities Exchange (ASX Limited); and five share trading registries.<sup>120</sup> The data is used across the ATO for educative and active compliance projects relating to: income tax, CGT, and the goods and services tax. For CGT, the third-party data is compared to taxpayers' income tax returns to identify whether any disposals of capital assets occurred in a financial year and, if so, whether the income derived from those disposals was reported. The process of comparing the external and internal data sources is referred to as data matching.

### *Data acquisition*

**4.13** The ATO's data matching activities are conducted under legislation and supported by ATO internal guidelines (corporate management practice statements, procedures and instructions) and external (voluntary) guidelines published by the Office of the Australian Information Commissioner.<sup>121</sup> Real property data from state and territory government sources is acquired either under a Memorandum of Understanding or s. 264 of the *Income Tax Assessment Act 1936* (ITAA 1936). Share data is acquired under s. 264 of the ITAA 1936. The ATO publishes notices of intended data matching programs in the Commonwealth Gazette.

### *Data transmission schedules*

**4.14** Third-party data is sent to the ATO either quarterly or biannually. The data providers can choose to supply either a client's full record from 20 September 1985 (the operative date for CGT) or an incremental refresh of the data. The ATO has in place a standard approach for receiving the data, however, there is currently no standard reporting format for data sent by the third-party data providers. The ATO has systems and processes in place to manage the collection of data, and the limitations are well known and documented by the ATO. The implementation of the 2013–14 Budget measure (for third-party data) is designed to improve the consistency of third-party data for ATO purposes.

### *Data matching process*

**4.15** Figure 4.2 illustrates the movement of data from external third-party data providers to the ATO (data capture), and internally within the ATO's two

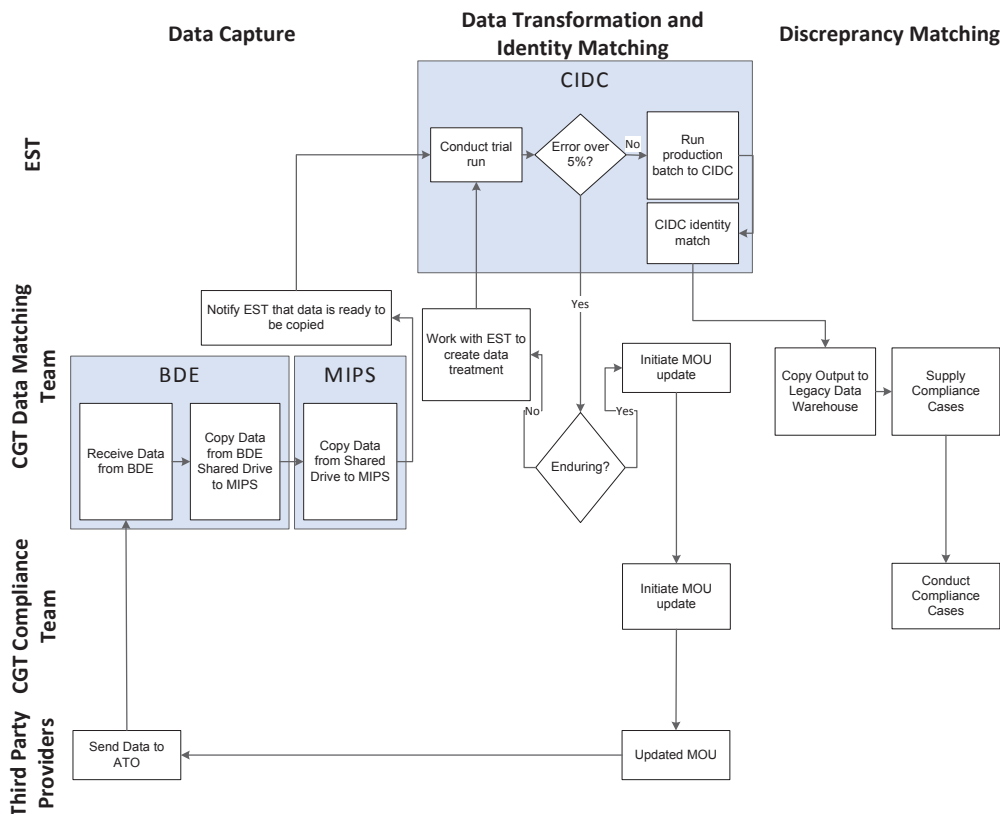
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120 Computershare Limited, Link Market Services Limited, Boardroom Pty Ltd, Advanced Share Registry Services Pty Ltd and Security Transfer Registrars Pty Ltd.

121 The Commissioner has formal information gathering powers under the ITAA 1936 and ITAA 1997. Data matching by Australian Government entities is regulated by the *Privacy Act 1998*. The ATO voluntarily aims to comply with the Office of the Australian Information Commissioner's *Guidelines on Data Matching in Australian Government Administration*, June 2014.

key processes (identity matching and discrepancy matching) that support CGT compliance activity for individual taxpayers.

**Figure 4.2: Data matching process for individual taxpayers**



Source: ATO.

Note: Abbreviations used in the figure are: Bulk Data Exchange (BDE) is an automated process; Client Identification Compliance (CIDC) system is an identity matching engine; Enterprise Solutions and Technology (EST) is a work area in the People, Systems and Services Group of the ATO; Magnetic Information Processing Services (MIPS) transfers data from the BDE to CIDC; and Memorandum of Understanding (MOU).

### Control framework and rules for data matching

**4.16** The ANAO assessed the IT control framework for CGT data matching for individuals, including its design and the operation of matching rules. In particular, the ANAO examined: the main elements shown in Figure 4.2—data capture, identity matching and discrepancy matching; and data storage and destruction. Overall, the ANAO concluded that the:

- core identity matching engine (CIDC) is a mature and effective system for CGT purposes. It is a reliable system and reported issues are actioned in a timely manner;
- data matching solution for CGT has been refined over time and is considered to be effective for that purpose;
- controls, for known risks, for the BDE, CIDC and MIPS core systems are appropriate<sup>122</sup>; and
- no issues were identified from a review of the data storage processes.<sup>123</sup>

### *Identity matching results*

**4.17** The purpose of identity matching is to establish the taxpayer (through a tax file number) that had a transaction recorded in an incoming data set that may be a capital gains event. The ATO uses the CIDC system for identity matching, which rates the match quality using a spectrum of different confidence levels ranging from high to low. The DMCS data matching team only uses those matched records rated as either 'high' or 'medium' for further risk assessment. Table 4.1 shows three examples of the codes for match quality and matching variables used for identity matching.

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122 Change management for these systems is effective and is reviewed twice a year by the ANAO's Assurance Audit Services Group for the IT General Control Audit, which is part of the ATO's annual financial statement audit

123 The ANAO also identified some potential areas for the ATO to review as part of its overall operation of the data matching systems, which were discussed with the ATO during the audit.

**Table 4.1: Examples of identity matching codes and descriptions for individual taxpayers**

Code	Match quality	Match based on
HDA	This is a <b>high quality</b> match, which can be used where a very high level of confidence in the matching result is required.	<ul style="list-style-type: none"> <li>• Name</li> <li>• Full date of birth</li> <li>• Address identifier</li> <li>• Postcode</li> </ul>
HIB	This is a <b>medium quality</b> match, which can be used where a medium level of confidence in the matching result is required.	<ul style="list-style-type: none"> <li>• First initial of first given name and surname</li> <li>• Full date of birth</li> <li>• Address identifier</li> <li>• Postcode does not match</li> </ul>
HPC	This is a <b>low quality</b> match, which can be used where a low level of confidence in the matching result is adequate.	<ul style="list-style-type: none"> <li>• Name</li> <li>• Postcode</li> <li>• No date of birth</li> </ul>

Source: ANAO analysis of ATO documents.

**4.18** Table 4.2 presents the results from CGT identity matching processes for the previous two financial years.

**Table 4.2: Third-party data identity matched to individual taxpayers, 2012–13 to 2013–14**

	New records received <sup>1</sup> (million)		Records identity matched (high/medium) (million)		Matched (percentage)	
	2012–13	2013–14	2012–13	2013–14	2012–13	2013–14
Real property	1.6	7.1	1.1	5	69.9	69.8
Shares	10.8	10.2	9.3	8.9	85.8	86.6
<b>Total<sup>2</sup></b>	<b>12.4</b>	<b>17.4</b>	<b>10.4</b>	<b>13.8</b>	<b>83.8</b>	<b>79.7</b>

Source: ANAO analysis of ATO data.

Note 1: Third-party data is sent to the ATO either quarterly or biannually and, for real property, can be either transaction records dating from the start of the CGT system, in 1985, or an incremental refresh—new records.

Note 2: Totals may not equal the sum of components due to rounding.

**4.19** The number of real property transaction records can vary from year to year.<sup>124</sup> In 2013–14, for example, the ATO requested additional fields in the real

<sup>124</sup> The number of transaction records is not equivalent to actual real property sales. Transaction records for a sale can be provided by more than one agency (state or territory government third-party data provider) in the same jurisdiction.

property records, which increased the number of new records by 5.5 million (over 300 per cent). However, the identity matching rates<sup>125</sup> for real property and share transactions were similar in 2012–13 and 2013–14 at 70 per cent and approximately 86 per cent respectively.

**4.20** During the testing of CGT compliance cases for Chapter 6, the ANAO observed a small number of instances (eight) where various multi-match resolution codes<sup>126</sup>, rated as having a high or medium quality match, produced identity mismatches when used for compliance activity with taxpayers. While the number of cases was small, there would be benefit in identifying those cases for further manual profiling before final case selection, or the compliance teams conducting short-term monitoring to collect any feedback to send to the data matching team about the use of those resolution codes.

### *Matching results*

**4.21** An integral part of the CGT compliance process is the ongoing development of data matching algorithms, using the real property and share data models, to identify potential CGT discrepancies, including omissions, in taxpayers' income tax reporting. Information contained in the third-party data is also used by the ATO to calculate taxpayers' potential CGT obligation and, if required, the ATO sends individual taxpayers correspondence seeking confirmation or amendment of the calculation (as detailed in Chapter 6). Table 4.3 summarises the real property and share transaction records and compliance cases finalised for individual taxpayers for the previous two financial years.

**Table 4.3: Transaction records and cases finalised for individual taxpayers, 2012–13 to 2013–14**

	2012–13	2013–14	Total
Third-party data received (new records)	12.4 million	17.4 million	29.7 million
Third-party data identity matched (high/medium)	10.4 million	13.8 million	24.2 million
Matched real property and share transactions	3.2 million	5.6 million	8.8 million
Cases finalised for individual taxpayers	12 574	6153	18 727
Cases finalised to matched transactions	0.39%	0.11%	0.21%

Source: ANAO analysis of ATO data.

Note: Totals may not equal the sum of components due to rounding.

<sup>125</sup> These match rates are for high and medium quality match codes.

<sup>126</sup> A multi-match occurs when more than one record in the ATO client register has satisfied the matching requirements for a given transaction at a particular matching level.

**4.22** Table 4.3 shows the results of the matching processes (identity and transactions) that support the selection of CGT cases for individual taxpayers. The ATO identifies potential CGT discrepancies from the matched real property and share transactions. The matched real property transactions are used to construct a history, which could identify a potential CGT event or identify a taxpayer's main residence that is exempt from CGT. The matched share transactions are important because they can assist the ATO to identify a subsequent CGT event. For example, the record over time of dividend reinvestments before the taxpayer sells the shares for a capital gain.

**4.23** While millions of new records are matched—17.4 million new records in 2013–14 resulted in 5.6 million (32 per cent) matched transactions—the actual number of CGT cases finalised in the last two years represented less than 0.5 per cent of the matched real property and share transactions. The CGT active compliance program for individual taxpayers has also placed a heavy emphasis on real property with only a limited focus on shares and other types of assets.

### **ATO identified issues with real property and share data**

**4.24** The ATO is aware of the limitations of the current collection methodology for real property data from state and territory governments. The issues have been summarised by the ATO as follows:

- addresses not standardised—for example, a corner block can have two different street addresses;
- data is acquisition, not vendor, based—which requires the ATO to construct a property's history by matching previous disposal and acquisition records;
- date fields are incomplete or inaccurate—for example, if a contract date is not provided the ATO uses the settlement date (if provided) to estimate the contract date, which can cause issues in identifying the year a CGT event occurred; and
- lack of unique identifiers—most of the property data does not have a unique identifier (such as a person's date of birth) that can be used to match a property to an individual taxpayer, which affects the identity match rate.

**4.25** The 2013–14 Budget measure (for third-party data) seeks to improve the value of the real property data collected by the ATO for compliance



activity by formalising the data reporting requirements, including capturing unique identifiers.

### *Share data limitations*

**4.26** There are also a number of known factors that impact on the ATO's ability to use the data from share transactions for CGT compliance activity. Taxpayers may hold shares for a number of years and, for CGT purposes, records are required dating back to 20 September 1985 to enable data from share registries to be compared with information in income tax returns. The ATO performs a manual calculation, using a number of transaction records, to arrive at an estimate of an individual taxpayer's capital gain, if any, and their CGT liability, and whether or not the gain was omitted or incorrectly reported in the applicable financial year.

**4.27** In anticipation of the 2013–14 Budget measure being implemented, the ATO advised that DMCS is currently piloting a new letter format for data matched share transactions designed to increase the use of that data for compliance cases after the Budget measure is introduced. The revised approach identifies that a taxpayer has disposed of shares, a financial gain is likely, and no CGT amount has been included in the taxpayer's return. The letter presents the share transaction data available to the ATO and asks taxpayers to provide details of the acquisition and disposal of the shares, including cost base calculations and details of any capital gain or loss. DMCS advised that the pilot will assist in developing future case pools and letter strategies for individual taxpayers. The results from the pilot will also be reviewed to identify potential areas for improvements to the business rules, letter template and CGT calculations.

## **External reviews of ATO data matching**

**4.28** The ANAO reviewed the ATO's use of data matching in 2007–08.<sup>127</sup> The objective of the 2007–08 audit was to evaluate the ATO's corporate management of data matching, including analytics. While making six recommendations for improvement, the ANAO concluded that the ATO was making use of its data matching and analytical capabilities in a more corporate and strategic way.<sup>128</sup>

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127 ANAO Audit Report No.30 2007–08 *The Australian Taxation Office's Use of Data Matching and Analytics in Tax Administration*.

128 *ibid.*, p. 17.

**4.29** A recent report by the Inspector-General of Taxation (IGT), in the context of the 2013–14 Budget measure states:

As the data matching program continues to expand, the IGT considers that the ATO needs to identify the areas in which its data matching work is effective and those in which it is less effective.<sup>129</sup>

The desired outcome, from the IGT's perspective (and supported by the ANAO), would be an improvement in ATO compliance processes, and reduced costs for taxpayers and the ATO due to more effective data matching. The IGT recommended that the ATO: formalise a strategic enterprise approach to the collection and application of third-party data used in its data matching activities; and consolidate its evaluations of data matching projects to capture observations made during those projects. The ATO agreed to the recommendation and is working on its implementation.

## **Stakeholder feedback**

**4.30** As previously discussed, the ANAO identified a range of organisations as potential stakeholders for the CGT audit and held meetings during audit fieldwork with taxpayer and professional body representatives. The stakeholder feedback received suggested that the ATO's third-party data matching processes had improved since the previous ANAO audit, as had the selection of compliance cases.

## **Future improvements to capital gains tax case selection**

**4.31** The CGT system was introduced in 1985. The 2006–07 ANAO audit found that:

During the first 12 years of Australia's CGT regime, the ATO did not have a comprehensive approach to identifying and treating CGT compliance risks. Between 1997 and 2003 it made isolated attempts to better comprehend or quantify CGT compliance in geographical areas or for large events. These did not progress for reasons ranging from funding, resourcing, and skilling to prioritisation of perceived higher risks.<sup>130</sup>

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129 Inspector-General of Taxation, *Review into the Australian Taxation Office's compliance approach to individual taxpayers—use of data matching*, IGT, Sydney, 2013, p. 43.

130 ANAO Audit Report No.16 2006–07 *Administration of Capital Gains Tax Compliance in the Individuals Market Segment*, p. 13.

**4.32** In 2003, the ATO established an enterprise risk owner for CGT and, with an increase in funding for CGT administration, the ATO approached state and territory governments in 2004 to explore opportunities for acquiring bulk real property data.

**4.33** Since the previous ANAO audit, and the establishment of the acquisition program for real property and share transaction data, there have been no significant enhancements in the ATO's administration of the CGT system aside from incremental improvements in data matching activities in the individual taxpayers market. The ATO advised that the refinements include: identifying additional real property sub-risks, such as vacant land; excluding real properties from the case pool that appear to be a main residence and, therefore, exempt from CGT; and improving the identity matching rates over time.

**4.34** In the subsequent eight years, the ATO investigated other potential areas for CGT compliance activity. The areas investigated were for:

- individual taxpayers: collectables, including art (August 2012); and acquisitions of gold and platinum (March 2012); and
- small business taxpayers: the sale of taxi licence plates (February 2014).

**4.35** The ATO advised that the two investigations in 2012 were not finalised, and further work was undertaken during 2014–15 to support future compliance activity. The investigation of the sale of taxi licence plates was rated as a low priority in 2014, with preliminary work conducted to support a potentially broader investigation in the long term.

**4.36** Part of the impetus in 2013–14 to seek improvements to third-party data, through the Budget measure, was: existing data that indicated CGT revenue is at risk due to taxpayers not complying with their obligations; and limitations on the ATO's ability to identify capital gains that have been omitted or incorrectly reported in income tax returns. The ATO is seeking the ability to identify CGT events in a timely manner and enable pre-filling of CGT information in taxpayers' income tax returns to encourage voluntary compliance. The ATO also needs to develop other areas for CGT compliance activity in SB/IT, involving other types of recorded asset sales, to effectively address CGT compliance risks.

## Conclusion

**4.37** CGT cases for DMCS and SBC are identified on the basis of potentially omitted or incorrect CGT reporting by taxpayers. An automated data matching process for individual taxpayers, used by DMCS, generates thousands of potential cases each year (6153 CGT cases were finalised in 2013–14). Considerably fewer potential cases for small business taxpayers are initially identified and finalised in SBC (406 CGT cases were finalised in 2013–14). The arrangements in place for CGT case selection are generally appropriate for the different market segments.

**4.38** The ATO regularly receives third-party data from sources nationally containing millions of records of real property and share transactions (in the last two years, 29.7 million new records were received). Once the transactions relating to taxpayers that are compliant with their CGT obligations are identified and set aside, transactions that detect potential CGT discrepancies, and also meet a range of business rules, are available for DMCS compliance activity. From 2012–13 to 2013–14, some 19 000 cases were finalised for individual taxpayers using those transactions. The IT control framework supporting data matching for individual taxpayer compliance cases is mature and effective for CGT purposes.

**4.39** Following the full implementation of data matching for CGT for individual taxpayers, there have been no significant enhancements in the ATO's administration of the CGT system or its management of case selection for some time. For individual taxpayers, the ATO has identified issues that limit the use of both real property and, moreover, share transactions data for conducting CGT compliance activity that will need to be overcome to increase the effectiveness of case selection processes.

**4.40** The ATO is relying on the implementation of the Budget measure in 2016 to improve case selection processes for individual taxpayers and increase its ability to identify capital gains that have been omitted or incorrectly reported in income tax returns. In the interim, the ATO is seeking to identify CGT events in a timely manner and enable pre-filling of CGT information in taxpayers' income tax returns to encourage voluntary compliance and reduce the potential for unintentional omissions of capital gains.

## 5. Encouraging Voluntary Compliance

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*This chapter examines the ATO's activities to promote voluntary compliance with capital gains tax obligations by individual and small business taxpayers.*

### Introduction

**5.1** The ATO seeks to design and operate a tax system for the majority of people in the community who do the right thing in relation to their tax obligations, rather than the minority who do not. The ATO seeks to foster willing participation through conducting voluntary compliance activities that encourage taxpayers and their representatives to understand and comply with their obligations.

**5.2** The ANAO examined the ATO's key voluntary compliance strategies for CGT:

- marketing, communication and education—making it easy for taxpayers to comply by providing information and guidance; and
- interpretive assistance—supporting taxpayers to comply by clarifying taxation laws through public and private rulings.<sup>131</sup>

### Marketing, communication and education

**5.3** The ATO has available a wide range of marketing, communication and education strategies and employs a variety of delivery channels to assist taxpayers to understand and voluntarily comply with their tax obligations. The marketing and education functions for SB/IT are carried out by the Community Engagement and Marketing stream with its functions split between individual and small business taxpayers. This stream had the equivalent of one full-time employee allocated to CGT marketing and communication activities in 2013–14.

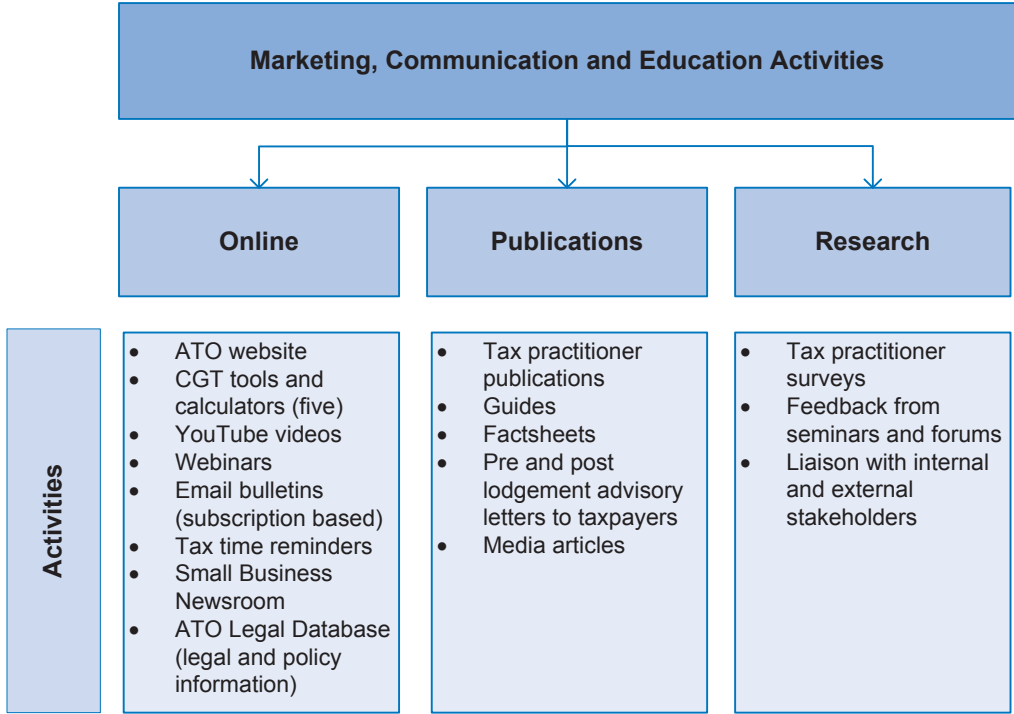
**5.4** The diversity of taxpayers who may encounter a CGT event, and the frequency of events, means that the ATO needs to tailor its communications for a broad audience, ranging from individual homeowners and small businesses to professional tax advisers. The range of activities to encourage and support

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<sup>131</sup> 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.

voluntary compliance for CGT by individual and small business taxpayers is summarised in Figure 5.1.

**Figure 5.1: Summary of marketing, communication and education activities for capital gains tax**



Source: ANAO analysis of ATO information.

Note: A number of publications can also be accessed online from the ATO's website.

**5.5** As illustrated in Figure 5.1, the ATO is providing support for CGT matters to taxpayers in both market segments. This approach is consistent with the current risk analyses for CGT (see Chapter 3) that requires the ATO to maintain ongoing marketing, communication and education activities.

**5.6** The ATO recorded approximately 331 000 visits<sup>132</sup> to the CGT home page on its website in 2013–14. The web usage statistics overall indicate active use of

<sup>132</sup> A visit is recorded once per person (per page) each time they look at the website. If someone looks at the same page 10 times, this is only one visit. Visits are used as an indication of how many 'people' have looked at the page, noting that if someone leaves the website and comes back, a new visit will be recorded.

the ATO's website pages dedicated to CGT information.<sup>133</sup> In 2014–15, the ATO is undertaking an enterprise-wide project to rationalise the content of its website (including a review of the large suite of CGT content) and improve the experience for users. There would be merit in the ATO evaluating the changes made to the CGT content to assess the impact on users.

**5.7** While stakeholders interviewed by the ANAO during the audit were balanced in their comments about the operation of the CGT system, suggestions were made for improving the administration of CGT that related to the ATO's marketing, communication and education activities, including:

- making more information available to taxpayers, in plain language, and as early as possible, to reduce the number of audits and objections;
- providing advice or new tools about the CGT implications of demergers<sup>134</sup> and how to treat assets and liabilities;
- simplifying the existing guides for CGT and focusing on addressing the most common CGT events, for example, the top 10 events rather than all 53 events<sup>135</sup>;
- highlighting potential major CGT events with taxpayers and tax agents, such as the Medibank Private share offer as there is a high level of tax agent involvement in preparing income tax returns for individual taxpayers and small businesses with CGT events<sup>136</sup>; and
- maintaining and/or increasing the ATO's focus on proactive education activities, including specific tax time reminders about CGT obligations.

## Measuring the effectiveness of communications strategies

**5.8** Fundamental to the success of any communications strategy is being able to clearly articulate the rationale for the strategy, identify the target audience,

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133 For example, in 2013–14, the ATO's primary web page content for 'Working out your capital gain or loss' received 99 455 visits, and the small business concession tool received 5226 visits.

134 A demerger involves the restructuring of a corporate or fixed trust group by splitting its operations into two or more entities or groups. ATO, *Demergers* [Internet], ATO, Canberra, 2014, available from <<https://www.ato.gov.au/general/capital-gains-tax/in-detail/shares,-units-and-similar-investments/demergers/>> [accessed 28 November 2014].

135 Stakeholder views on the value of the ATO's guides for CGT were mixed as some found the guides to be readily available on the ATO's website and noted improvements in the content.

136 In 2013–14, over 10 million individual taxpayers lodged a tax return, of which approximately 620 000 taxpayers (5.8 per cent) included a CGT event in their lodgement. Tax agent involvement in preparing returns for individual taxpayers was 69 per cent and 95 per cent respectively.



and measure the strategy's effectiveness. It is important that the ATO adopts this approach for measuring the return on investment for CGT marketing and education activities, given the limited resources available in the BSL for CGT activities. Table 5.1 summarises the ATO's communication strategies and evaluations for individual and small business taxpayers.

**Table 5.1: Communication strategies and evaluations, 2012 to 2016**

Activity type	Individuals	Small business
Communication strategy	<p>Draft <i>Investors Communication Framework 2013–16</i></p> <p>Specific campaigns:</p> <ul style="list-style-type: none"> <li>• <i>Removal of Capital Gains Tax Discount for Foreign Residents Communication Strategy (2012–13)</i>; and</li> <li>• <i>CGT General Discount Calculator Communication Plan (2013–14)</i></li> </ul>	<p><i>CGT (Micro Business) Communication Strategy (2012–13)</i></p> <p><i>CGT (Small Business) Communication Strategy (2013–14)</i></p> <p><i>CGT (Small Business) Communication Strategy (2014–15)</i></p>
Evaluation	<p><i>CGT General Discount Calculator Evaluation Report (2013–14)</i>:</p> <ul style="list-style-type: none"> <li>• in progress</li> </ul>	<p><i>2012–13 Results Report</i></p> <p><i>2013–14 Results Report</i></p>

Source: ANAO analysis of ATO documents.

**5.9** The communication strategies for SBC from 2012 to 2015 addressed: compliance risks and drivers; target audiences<sup>137</sup>; communication objectives; key messages; timing for activities; and evaluation methods. The two results reports outline the results from a number of marketing and communication activities including, in the 2013–14 evaluation:

- circulation results for paper and electronic publications such as newsletters, which ranged from some 27 000 subscribers to a circulation of 2.7 million tax practitioners; and
- the number of views of electronic guides on the ATO's website, ranging from 33 000 views to 321 000 views for the most popular general guide to CGT.

<sup>137</sup> The primary audience is small businesses at all stages of the business lifecycle (new, existing and exiting) and tax practitioners. The secondary audience includes professional associations, online communities, software developers and the media, that can influence the compliance behaviour of small businesses and tax practitioners. ATO employees are the internal audience.



**5.10** For the individuals market, the content of a draft *Investors Communication Framework 2013–16* aims to address research, target audiences, communication objectives and key messages. The ATO advised that, due to the lack of designated staff, coupled with CGT being considered a low compliance risk, communication evaluation reports have not been produced in recent years. There was also no evaluation of the *Removal of Capital Gains Tax Discount for Foreign Residents Communication Strategy (2012–13)*. However, this approach to evaluation is not consistent with the ATO's risk profile for CGT for individuals and small business, which rated the risk for both markets as 'high'. A high risk rating means that it is a priority for compliance activity—including encouraging voluntary compliance by taxpayers through marketing, communication and education activities—and monitoring of the risk by the BSL.

**5.11** CGT events are not a regular occurrence for most taxpayers and tax professionals provide a high level of support when lodging tax returns that include CGT. While this context presents a challenge for measuring the effectiveness of communication strategies for CGT, SBC has been able to evaluate the CGT communication strategies for small businesses, within the ATO's broader communications with small business taxpayers and their tax professionals. There would be benefit in DMCS evaluating, in a similar way, whether its involvement in communication activities supports individual taxpayers and their tax professionals to understand and voluntarily comply with CGT obligations.

## Interpretive assistance

**5.12** Interpretative assistance delivered by the ATO is intended to help taxpayers by providing the Commissioner of Taxation's opinion about the application of taxation laws. Different types of advice and guidance are provided and these vary in the level of protection afforded to taxpayers who rely on this information. Advice is binding on the Commissioner, and is generally provided in the form of a ruling, whereas guidance sought by a taxpayer is not binding on the Commissioner.

### Types of interpretive assistance

**5.13** The Interpretive Assistance stream in SB/IT provides technical advice about rulings, interpretative guidance and objections within the BSL to the active

compliance areas for the individual and small business markets. Table 5.2 shows the number of CGT-related interpretive assistance rulings<sup>138</sup> and guidance delivered by the ATO in the last three years that impacted directly or potentially on individuals and small businesses.

**Table 5.2: Interpretive assistance rulings and guidance for capital gains tax, 2011–12 to 2013–14**

Product	2011–12	2012–13	2013–14
Private rulings	1033	955	1138
Public rulings <sup>1</sup>	17	3	1
Guidance	225	265	263
<b>Total</b>	<b>1275</b>	<b>1223</b>	<b>1402</b>

Source: ATO.

Note 1: Includes class rulings.

**5.14** Almost 4000 items of interpretive assistance for CGT were finalised in the three years shown in Table 5.2. Most of the interpretive assistance products were private rulings (3126 or 80 per cent), which primarily covered matters relating to: deceased estates; small business concessions; main residence exemptions; shares; subdivisions; and trusts. The number of items of interpretive assistance for CGT reported in the 2006–07 ANAO audit<sup>139</sup> are comparable to those in the years 2011–12 to 2013–14. A stakeholder observed during the current audit that the rulings system is complex and there is a large volume of CGT guidance products available.

**5.15** Stakeholders, in discussing the rulings process with the ANAO, also commented that:

- rulings on tax matters by the ATO have helped tax agents to better understand CGT and their subject matter expertise is higher now than at the time of the previous ANAO audit; and

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138 A private ruling is a written expression of the Commissioner's opinion about the way in which the law applies or would apply to a particular taxpayer in their particular circumstances. A public ruling is written binding advice, published by the Commissioner of Taxation (Commissioner) for the information of entities generally, on the way in which, in the Commissioner's opinion, the law applies or would apply to entities generally, or a class of entities.

139 The 2006–07 ANAO audit identified that 1419 private rulings on CGT topics were issued in 2005–06 (1276 were issued in 2004–05). The rulings also covered: main residence exemptions; deceased estates; and shares and unit trusts. ANAO Audit Report No.16 2006–07 *Administration of Capital Gains Tax Compliance in the Individuals Market Segment*, p. 70.

- the rulings process could be improved by more clearly stating when to seek a ruling on CGT and the ruling itself should be as definitive as possible.

**5.16** The ATO advised that questions about CGT from individual taxpayers and tax practitioners comprise approximately 25 per cent of the total private rulings for the individual and small business markets. The ATO suggested that the number of requests reflects the complexity of CGT law and the potentially long time periods associated with maintaining records for CGT events.

### **Timeliness of private rulings**

**5.17** In 2013–14, the ATO commenced a transition from ‘service standards’ to ‘service commitments’ (that is, the level of service the ATO commits to providing its clients under usual circumstances) and introduced new performance measures. One of the five service commitments is the ‘timely’ provision of services, which has an ongoing performance measure that: 80 per cent of private rulings are finalised in 28 calendar days of receiving all necessary information.<sup>140</sup> There are no published performance measures for public rulings and interpretative guidance.<sup>141</sup>

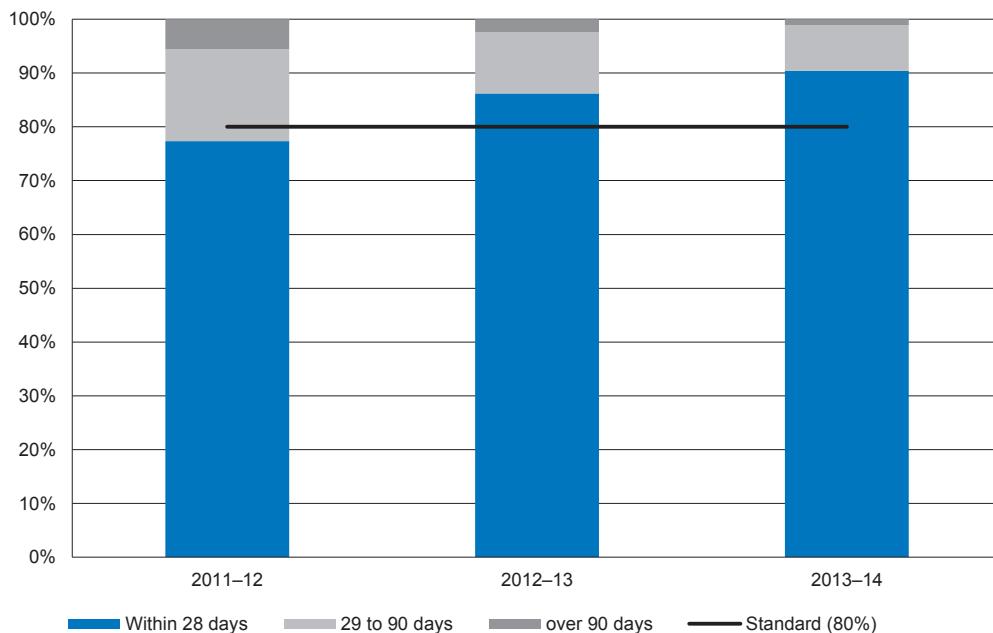
**5.18** The timeliness of private rulings finalised for CGT matters from 2011–12 to 2013–14 is presented in Figure 5.2.

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<sup>140</sup> ATO, *Access, accountability and reporting* [Internet], ATO, available from <<https://www.ato.gov.au/About-ATO/Access,-accountability-and-reporting/Our-commitments-to-service/Current-year-commitments-to-service/>> [accessed 8 January 2015].

<sup>141</sup> The Interpretive Assistance stream defined a ‘timely standard’ as finalising interpretative guidance within 28 days. A total of 753 items of guidance were finalised from 2011–12 to 2013–14 and 84 per cent (633) met the standard.

**Figure 5.2: Timeliness of capital gains tax private rulings, 2011–12 to 2013–14**



Source: ANAO analysis of ATO data.

**5.19** Figure 5.2 highlights that the ATO has improved its performance for finalising CGT private rulings in the last three years and met the performance measure for timeliness in the last two years. Interpretive Assistance staff advised the ANAO that they informally provide feedback to the DMCS and SBC compliance teams and Community Engagement and Marketing stream about observable trends in advice and guidance work, which could be used to reduce the number of taxpayer requests and decrease the ATO's response times for private rulings. The type of feedback being provided by Interpretive Assistance staff included information about risks and trends in inquiries, for example, an increase in advice being sought about Bitcoin transactions.<sup>142</sup>

**5.20** The high volume of requests means that the private rulings process is substantial for the ATO. Many hours can be required to research and determine taxpayers' obligations for CGT and there is a potential financial impact from a ruling for both parties. Of the total private rulings issued from 2011–12 to

<sup>142</sup> The ATO's view is that Bitcoin is an asset for CGT purposes. ATO, *Tax treatment of crypto-currencies in Australia – specifically bitcoin* [Internet], ATO, available from <<https://www.ato.gov.au/general/gen/tax-treatment-of-crypto-currencies-in-australia---specifically-bitcoin/>> [accessed 26 February 2015].

2013–14 (3126), almost half (1512) were fully or partly favourable for the ATO, 721 were unfavourable and 497 were withdrawn.

## Conclusion

**5.21** The ATO is providing appropriate marketing, communication and education assistance for CGT matters to a diverse range of taxpayers in both the individual and small business markets. Nevertheless, the ATO would benefit from undertaking an annual evaluation of the effectiveness of its CGT communication strategy for individual taxpayers.

**5.22** The large volume of CGT guidance products available from the ATO, which included almost 4000 interpretive assistance products finalised in the last three years, highlights the complexity of the CGT system. Most of the interpretive assistance products were private rulings (3126 or 80 per cent). In the last three years, the ATO has improved its timeliness performance for finalising CGT private rulings, which have a potential financial impact for both taxpayers and the ATO.

## 6. Conducting Compliance Activities

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*This chapter examines the ATO's activities to address non-compliance by individual and small business taxpayers that do not comply with their capital gains tax obligations.*

### Introduction

**6.1** Active compliance refers to the range of ATO activities that are designed to detect taxpayers who are not meeting their obligations under tax law. Activities can include routine letter and telephone contact with taxpayers through to reviews and audits, which are more resource intensive examinations of the affairs of a taxpayer and can take a lengthy period of time to conclude.<sup>143</sup> There are also penalty and interest processes in place to treat non-compliance, including evasion or fraud.

**6.2** In 2013–14, the ATO planned to undertake CGT compliance work in all major market segments, including the individual and small business markets.<sup>144</sup> Different compliance strategies are in place for CGT in the DMCS and SBC streams in recognition of the different composition of those markets. SBC conducts specific reviews and audits of small businesses and DMCS uses a letter strategy (the bulk mailouts of letters) for individual taxpayers.

**6.3** The ANAO examined the conduct of recent CGT active compliance work by assessing:

- small business audits and reviews;
- individual taxpayer letter campaigns; and
- objections to the outcome of compliance cases.

### Small business audits and reviews

**6.4** The ATO undertakes compliance reviews and audits of those small businesses selected for compliance activity. Reviews are also a means for the ATO to collect intelligence and assess the risks concerning selected taxpayers. Any issues detected through a review may be escalated to an audit. Once a decision has been made to proceed with a review or audit, the primary contact

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143 ATO, *How we check compliance* [Internet], ATO, available from <<https://www.ato.gov.au/General/How-we-check-compliance/>> [accessed 8 January 2015].

144 ATO, *Compliance in focus 2013–14*, p. 29.

nominated to the ATO, usually the tax agent or the taxpayer, is informed of the ATO's decision.

**6.5** Table 6.1 summarises the small business CGT reviews and audits finalised by the ATO from 2011–12 to 2013–14.

**Table 6.1: Small business capital gains tax reviews and audits, 2011–12 to 2013–14**

2011–12			2012–13		2013–14	
	Cases finalised	Liabilities raised \$'000	Cases finalised	Liabilities raised \$'000	Cases finalised	Liabilities raised \$'000
Compliance Activity						
Review	315	457	244	3 939	162	4 731
Audit	219	58 582	214	50 264	244	25 547
Total	534	59 039	458	54 203	406	30 278
Cash collected <sup>1</sup>						
	10 700		15 400		7 600	

Source: ANAO analysis of ATO data.

Note 1: The cash collected amount includes: actual data for cases based on matching ATO account records of payments received and compliance case transactions; and an estimate of the value of cases where payments could not be attributed directly to CGT compliance activities. The ATO advised that for those cases where there is not a match, a sample rate is applied based on similar cases to estimate the cash collected. The cash collected also represents a point in time calculation as additional payments are likely to be received in the following year after a case was finalised.

## Cases finalised, liabilities raised and cash collected

**6.6** From 2011–12 to 2013–14, approximately 1400 review and audit cases were finalised by SBC compliance teams and \$143.5 million in liabilities was raised.<sup>145</sup> The ATO advised that the cash collected, from the liabilities raised, rose from \$10.7 million (18 per cent) in 2011–12 to \$15.4 million (28 per cent) in 2012–13 before falling to \$7.6 million (25 per cent) in 2013–14. Of the \$143.5 million in liabilities raised, the ATO collected approximately \$34 million (24 per cent).

**6.7** As discussed in Chapter 2, SBC intends to undertake only 32 CGT specific review and audit cases in 2014–15, and the revenue target (liabilities

<sup>145</sup> See Chapter 2 for a discussion of ATO revenue targets for the small business market, which were not met in 2012–13 and 2013–14.

raised) is \$13.1 million.<sup>146</sup> These changes represent a significant decrease in the number of planned cases and the potential liabilities to be raised from the previous year—a 92 per cent reduction in cases and 57 per cent reduction in liabilities. The effect on cash collection rates will not be known until sometime after the cases are finalised.

**6.8** The ANAO sampled 95 SBC compliance cases from 2012–13 to 2013–14 (approximately seven per cent of the total cases finalised). The ANAO identified 26 cases (27 per cent) in the sample that had liabilities raised, totalling \$13.6 million—ranging from \$5.8 million for a single case to a negative liability (an amendment in the taxpayer’s favour) of approximately \$229 000. The average amount of the liabilities raised for these cases was approximately \$523 000. The cash collected (by April 2015) for the 26 cases was \$8.3 million (61 per cent).

**6.9** Table 6.2 provides an analysis of the time taken by SBC to complete the 95 cases reviewed by the ANAO, based on the ATO’s descriptions of case cycle times.<sup>147</sup>

**Table 6.2: Cycle time for small business capital gains tax sample cases, 2012–13 to 2013–14**

Case cycle met, or exceeded by range of days <sup>1</sup>	Number of cases	Percentage of cases	Liabilities raised \$'000	Percentage of liabilities raised
In cycle	60	63.2	456	3.4
Less than five days	6	6.3	56	0.4
Five to 10 days	4	4.2	—	—
Ten to 50 days	7	7.4	—	—
Over 50 days	18	18.9	13 093	96.2
<b>Total</b>	<b>95</b>	<b>100.0</b>	<b>13 605</b>	<b>100.0</b>

Source: ANAO analysis of ATO data.

Note 1: Case cycle descriptions were sourced from ATO data.

**6.10** Sixty of the 95 cases were finalised by SBC within the expected cycle time (63 per cent), although these cases represented less than four per cent of the total liabilities raised. Conversely, almost 20 per cent of the cases (18 cases) that took

146 CGT is also included as a component of SBC’s comprehensive audit program for small businesses.

147 Cycle times refer to the elapsed timeframe for completion of a review or audit as determined by the compliance team at the start of the case examination. They vary depending on the type of activity and the complexity of the case.



in excess of 50 days beyond the cycle time accounted for approximately 96 per cent (\$13 million) of the total liabilities raised. The average liability raised for these 18 cases was approximately \$727 000. This distribution of cases across the sample reviewed by the ANAO indicates the importance of the ATO placing sufficient emphasis on liabilities raised from longer audits when balancing the achievement of timeliness targets with revenue outcomes when finalising small business CGT reviews and audits.

### **ANAO review of ATO administrative procedures for the conduct of CGT compliance cases**

**6.11** Small business cases can be diverse with complex circumstances and require a number of administrative procedures to be complied with during their conduct, to help ensure the integrity of the ATO's processes when dealing with taxpayers. To review SBC's application of administrative procedures for small business CGT compliance cases, the ANAO assessed the sample cases against the ATO's key requirements in four main areas; case context, client profile, case planning, and reporting case decisions. The ANAO also assessed if the required documents were retained in the appropriate ATO case management system. This means that the case details are accessible to other case officers or staff working on objections and also supports the quality assurance process. The ANAO's analysis is summarised in Table 6.3.

**Table 6.3: Results of procedural testing of small business capital gains tax cases**

ANAO criteria	Number of cases <sup>1</sup>	Number met ANAO criteria	Percentage of cases
Case context: <ul style="list-style-type: none"> <li>document attached and includes an overview of risk areas and any special instructions and timing advice</li> </ul>	88	62	70
Client profile: <ul style="list-style-type: none"> <li>sufficient client information available to support planning</li> </ul>	85	73	86
Case plan: <ul style="list-style-type: none"> <li>document attached and includes risks, methodology and timing</li> </ul>	75	72	96
Case report: <ul style="list-style-type: none"> <li>document attached and includes evidence, legislation and reasoning for the case decision</li> </ul>	61	39	64

Source: ANAO analysis of ATO data.

Note 1: Not all of the 95 cases selected for sampling required all of the key documents to be attached, as some cases that were finalised early did not proceed through all stages.

**6.12** Given the comparatively low percentage of cases in the ANAO sample that had a case report attached (64 per cent or 39 cases of a possible 61 cases), the ANAO examined the liabilities raised for those 61 cases in more detail. The analysis is presented in Table 6.4.

**Table 6.4: Sample of case reports and liabilities raised from sampled small business capital gains tax cases, 2012–13 to 2013–14**

Case report was present?	Number of cases	Liabilities raised \$'000	Average liabilities raised \$'000
Yes	39	13 423	344
No	22	82	4
<b>Total</b>	<b>61</b>	<b>13 504<sup>1</sup></b>	<b>221</b>

Source: ANAO analysis of ATO data.

Note 1: Total does not equal the sum of components due to rounding.

**6.13** Table 6.4 shows that for 22 cases in the ANAO's sample a case report was not retained in the appropriate ATO case management system, which means that the work could not be subject to a quality assurance process. The total liabilities raised for these cases was \$82 000. The ATO reviewed all 22 cases and advised that the records comprised:

- 14 cases without an adjustment, whereby in 12 cases the taxpayer was advised by correspondence that no further action was being taken; and
- eight cases with an adjustment, where the taxpayer (in five cases) was sent a letter advising of an automatic amendment, which did not require a case report.

**6.14** The other aspect of SBC's administration of small business CGT cases that could benefit from an increased focus is the recording of the case context. In the ANAO sample, 30 per cent of applicable cases did not have a document in the case management system that provided an overview of risk areas and special instructions for the conduct of the CGT case. Preparing this document, and making it available on the case management system, would better support planning for, and the conduct of, CGT active compliance cases.

### **Quality assurance for small business cases**

**6.15** Historically, the ATO used an Integrated Quality Framework (IQF) to manage the quality of its processes and products, including for case management. From 1 July 2014, the ATO is replacing IQF with 'ATO Quality', which is designed to simplify and streamline its approach to quality measurement.<sup>148</sup> The primary focus of IQF was to facilitate the consistency and correctness of administrative decisions made by staff, and identify opportunities for improvement. The IQF used a corporate sampling methodology to assess selected active compliance cases.<sup>149</sup>

**6.16** The enterprise-wide IQF enabled comparisons to be made between cases officers working in different office locations, BSLs and on different types of taxes. Until the end of June 2014, case officers in SBC were assessed using the IQF system. The ANAO reviewed the results of the IQF assessments for small business CGT cases from 2012–13 to 2013–14. The number of small business CGT cases subject to the IQF process was 87, or approximately 10 per cent of the 864 CGT cases finalised by SBC in the two-year period.

**6.17** In 2012–13, two cases failed the assessment for timeliness, and in 2013–14, three cases failed the quality measures for: administrative soundness, integrity and timeliness. The assessment for administrative soundness related to

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<sup>148</sup> ATO Quality is being phased in across the ATO. It was implemented in SB/IT in July 2014.

<sup>149</sup> The assessment involved rating nine quality measures (administrative soundness, integrity, correctness, appropriateness, effectiveness, transparency, consistency, timeliness, and efficiency) against five assessment ratings.

not sending a required advice letter to a taxpayer. However, there is insufficient detail provided by the IQF reviewer to explain the negative assessment for the integrity measure. Overall, the IQF results do not highlight any key trends or areas of concern as most cases met the corporate standards for quality across the nine quality measures.

## Individual taxpayer letter strategy

**6.18** The ATO primarily uses the bulk mailout of correspondence (letters that draw on third-party data) to address individual taxpayers' non-compliance with their CGT obligations. The letters are issued according to a weekly schedule prepared by DMCS.

**6.19** As shown in Table 6.5, over the last five years the ATO increased its capability to target a large number of taxpayers with a similar CGT compliance issue, however, the quantum of CGT cases and the liabilities raised has been variable. Following the negotiation of access to third-party data and pilot activities in 2009–10 and 2010–11, to test the proposed compliance strategy for individual taxpayers, DMCS expanded its data matching compliance activities to routinely include CGT from the disposal of real property and shares (the latter to a much lesser degree, as discussed in Chapter 4).

**Table 6.5: Capital gains tax cases for individual taxpayers, 2009–10 to 2013–14**

Cases and liabilities	2009–10 Pilot	2010–11 Pilot	2011–12	2012–13	2013–14
CGT cases	158	418	7664	12 574	6153
Liabilities raised (\$m)	0.2	6.4	93.6	203.9	104.7
Cash collected (\$m) <sup>1</sup>	— <sup>2</sup>	— <sup>2</sup>	34.9	59.7	20.2

Source: Data provided by the ATO in November 2014.

Note 1: The cash collected amount includes: actual data for cases based on matching ATO account records of payments received and compliance case transactions; and an estimate of the value of cases where payments could not be attributed directly to CGT compliance activities. The ATO advised that for those cases where there is not a match, a sample rate is applied based on similar cases to estimate the cash collected. The cash collected also represents a point in time calculation as additional payments are likely to be received in the following year after a case was finalised.

Note 2: A formal evaluation was not completed for the pilot years (see paragraph 6.30).

**6.20** Since 2009–10, the ATO has finalised approximately 27 000 cases and raised approximately \$409 million in liabilities from its CGT active compliance work with individual taxpayers. The cash collected from 2011–12 to 2013–14, (after the pilot) was \$114.8 million and represents 29 per cent of the liabilities raised in the three-year period.

**6.21** Initially, one of two types of letters is sent to taxpayers or their tax agent if they are the nominated contact:

- lodger—identified through data matching as having a CGT event in a financial year, but with potential discrepancies in the details in their tax return. The letter is pre-filled with information identified as being sourced from third-party records and is designed to verify statements of fact. The taxpayer is requested to contact the ATO (by phone, fax, mail or email) within 28 days from the date of the letter if they believe the information is incorrect. If there is no contact, the ATO will adjust the tax return, on the basis that the taxpayer agrees with the information, and issue a notice of amended assessment; and
- non-lodger—identified through data matching as having a CGT event in a financial year. If the taxpayer does not contact the ATO or, if required, lodge a return within the specified number of days—and a default warning letter has also been sent—the ATO issues a default assessment. The assessment is based on the income calculation (including CGT) provided in the default warning letter.

**6.22** The ANAO's analysis of ATO data showed that, over the last three years, approximately 21 899 taxpayers contacted the ATO by phone about a CGT letter sent by DMCS and approximately 20 273 taxpayers replied by correspondence.

#### *Case management systems for letters*

**6.23** In DMCS, case officers routinely use two IT systems to manage the cases for CGT letters sent to taxpayers:

- Windows Case Actioning System (WinCAS), the ATO's primary case actioning system for data matching cases; and
- Siebel, the ATO's enterprise case management system.

**6.24** The WinCAS system enables the ATO to: automatically finalise a case with no further action; progress automated amendments in appropriate cases; and allows ATO officers to reverse any amendments (or adjustments).<sup>150</sup> The WinCAS system is critical to the DMCS data matching program, which finalised approximately 480 000 cases in 2013–14, including cases for CGT. While

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<sup>150</sup> An administrative reversal can be performed by a case officer without the taxpayer lodging a formal objection. Based on evidence from the taxpayer, the ATO reverses or reduces an adjustment identified through data matching and included in a letter sent to the taxpayer to verify the facts.

WinCAS is a repository for notes about a case, access to the Siebel system is also required to: store taxpayer correspondence; and indicate to other ATO staff that a DMCS case is in progress. However, the Siebel case management system does not have the functionality to automatically amend cases in the same way as WinCAS, which means that Siebel does not support the high volume processing of cases. In practice, it would not be efficient for the ATO to automatically create a new case in Siebel for every taxpayer that is sent a CGT letter, in the expectation of multiple contacts or documents being provided in the future.<sup>151</sup>

**6.25** In September 2014, the ATO implemented a revised model for managing the more complex or ongoing cases of CGT. One case officer has ownership of the case until it is finalised and is responsible for maintaining appropriate records in WinCAS and Siebel. The ATO would benefit from evaluating the outcomes of using the new case ownership, from both the taxpayer's and case officer's perspective. The ATO could also consider increasing its use of Siebel where the case becomes complex, longstanding or subject to considerable communication with taxpayers that goes beyond the capacity of WinCAS to store sufficient notes about the case. Using Siebel for these cases would satisfy better practice record keeping requirements, and improve client service.

#### *ANAO analysis of cases*

**6.26** The ANAO examined a sample of CGT cases for individual taxpayers finalised by the ATO in 2012–13 and 2013–14, to determine the key processes undertaken and outcomes achieved. The ANAO drew an initial sample of 414 cases, which was reduced to 377 after excluding duplicates from the data provided by the ATO. During the course of the analysis, the ATO advised that letters were not sent to many of these taxpayers for various reasons, most commonly that a main residence exemption applied to the property in question. Consequently, the ANAO estimated that letters were sent to 322 taxpayers, including 166 (52 per cent) who had previously lodged an income tax return for the relevant year and 156 (48 per cent) who had not previously lodged.<sup>152</sup>

**6.27** Of the 322 cases where a letter was sent to a taxpayer, 131 cases (41 per cent) resulted in further action by the ATO. Eighty-two cases had

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151 The ATO advised that, in 2013–14, approximately one third of the CGT cases that were finalised were automatically amended.

152 The analysis of the letter data took into account both the notes that case officers had recorded on the WinCAS system about the treatment and outcomes of the cases and the codes applied by the case officer about the outcomes. Inconsistencies between these two elements of the data limited the assurance about the actual outcomes.

potential financial outcomes<sup>153</sup>, and 49 cases resulted in either the lodgement of a tax return or a default assessment.<sup>154</sup> Of the 82 cases with a financial outcome, 40 cases (or 49 per cent) had an administrative reversal without the taxpayer lodging a formal objection.<sup>155</sup>

**6.28** In the majority of the cases examined (191 of the 322 cases or 59 per cent), the ATO did not take any further action after sending the CGT letter to the individual taxpayer. Among the more common reasons for no further action in the cases examined were that letters were either returned to sender or no response was received from the taxpayer. In the ANAO's sample, 23 cases were identified as having been cancelled because they were returned to sender (with a total potential revenue gain of approximately \$348 900) and 15 cases were cancelled because of a natural disaster<sup>156</sup> (with a total potential revenue gain of approximately \$232 600).

**6.29** DMCS has a formal guideline for staff about how to action return to sender correspondence (June 2014), including for CGT cases. Once the cases have been identified and separately recorded, the case selection team for CGT is responsible for determining any further action including updating details, reissuing correspondence or cancelling the case. DMCS advised that, in the six months between 1 July 2014 and 31 December 2014, 421 cases came back to the CGT team as returned to sender. The team identified an alternative address and correspondence was reissued in 269 of the cases (64 per cent). The remaining 152 cases (36 per cent) were cancelled as an alternative address could not be identified.

### *Effectiveness of CGT letters to individual taxpayers*

**6.30** Before the implementation in 2011–12 of the bulk mailouts of CGT letters for individual taxpayers, DMCS did not prepare a formal evaluation report that recorded the outcomes from the 576 pilot cases undertaken from 2009–10 to 2010–11 (in Table 6.5). The available evaluations provided by the ATO from that time only covered CGT cases for share transactions. Real property cases were

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153 The taxpayer had previously lodged an income tax return and the financial outcome was reflected in a notice of amended assessment being sent to the taxpayer.

154 These non-lodger cases also resulted in liabilities being raised and cash collected in many instances.

155 Based on evidence from the taxpayer, the ATO may reverse or reduce an adjustment.

156 The ATO has adopted the principle that for many people and businesses impacted by natural disasters, tax will not be a priority and aims to defer matters relating to tax affairs until a later time.



not included and the evaluations did not recommend commencing bulk mailouts of CGT letters.

**6.31** The bulk mailouts of letters for individual taxpayers has produced mixed results since their implementation in 2011–12, including variable revenue amounts (see Table 6.5). For the ANAO’s sample of taxpayer cases there was:

- a high rate of cases where no further action was taken (59 per cent); and
- a high reversal rate where assessments were amended for taxpayers who had previously lodged tax returns (49 per cent).

**6.32** From the ATO’s perspective, the reversals process provides an improved client experience to that of the objections process (discussed in paragraph 6.43), by offering a more immediate resolution for taxpayers and is consistent with the Reinventing the ATO program. While the ATO has been responsive to client contact about CGT letters (with a low complaint rate as discussed in Chapter 2), in the ANAO’s sample there was little documentation indicating that compliance officers administering individual taxpayer cases had requested further information to verify taxpayers’ claims. While this could be partly a record keeping issue relating to the functionality of WinCAS, it could also be that little verification is undertaken, irrespective of the case’s financial materiality.<sup>157</sup>

**6.33** There is also rework involved for the ATO with amending assessments from CGT letters and a risk that taxpayers’ confidence in the administration of the tax system could be reduced. As discussed in paragraph 6.22, many thousands of taxpayers have contacted the ATO, by phone or correspondence, over the last three years about a CGT letter sent by DMCS. The results from the ANAO’s sample suggests that much of this contact would have related to reversing the ATO’s amended assessments, either in part or full.

**6.34** An active compliance program for CGT for individual taxpayers is an important element of administering the income tax system. However, DMCS has not evaluated the effectiveness of its active compliance CGT letter strategy for individual taxpayers in a way that would allow it to measure outcomes. On this basis, the ATO would benefit from evaluating the effectiveness of the bulk mailout of CGT letters to individual taxpayers, including measuring strike rates, overturn rates and cash collections (in total and as a percentage of the liabilities

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<sup>157</sup> For example, in one case the taxpayer’s oral claim for a main residence exemption, following a divorce, was accepted without written evidence being supplied. In another case, the ATO relied solely on figures provided through a tax agent.



raised). A focus of this evaluation could be whether the data about the potential CGT events is sufficiently accurate to warrant the ATO advising individual taxpayers of the need to address a potentially incorrect assessment.

### *Quality assurance for individual taxpayer cases*

**6.35** The ATO relies on its case officers maintaining two IT systems for the CGT cases (by letter for individual taxpayers) and having in place appropriate quality assurance measures to identify any issues that may arise from this case work. In DMCS, the quality assurance of compliance cases is managed in accordance with DMCS service standards, which were designed to be consistent with the IQF.<sup>158</sup> For example, local team-based quality assurance activities involve monthly checks of a number of phone and correspondence activities for each team member. DMCS advised that new quality assurance processes are currently being developed to align with the new ATO Quality process.

**6.36** CGT case teams have clear performance standards in place for managing phone calls and correspondence that include targets and measureable performance standards, which support weekly and year-to-date monitoring. In the first quarter of 2014–15, the CGT case teams were meeting the performance standards for phone calls and correspondence. The number of CGT phone calls offered (at year to date, September 2014) was 1910, of which 1870 (97.9 per cent) were answered and the number of items of correspondence received was 948 and 1061 were finalised. The (year to date) service commitment result for CGT phone calls was 96.7 per cent (of the total calls offered and answered) and for correspondence was 97.5 per cent (finalised within 28 days) and 99.6 per cent (finalised within 90 days).

**6.37** Nevertheless, in 2013, the Inspector-General of Taxation<sup>159</sup> identified a number of issues with the ATO's use of discrepancy letters to taxpayers that were based on data matching, including letters sent for CGT purposes. The issues identified in the report included: letter tone and content; rate of response by taxpayers to ATO discrepancy letters; and requesting information from taxpayers. The ANAO's analysis of the sample of CGT compliance cases for individual taxpayers identified the following issues:

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158 DMCS advised that, previously the stream's Capability Support and Assurance team conducted quality assurance checks on a set number of activities per month across DMCS nationally and assessed these in line with the IQF.

159 Inspector-General of Taxation, *Review into the Australian Taxation Office's compliance approach to individual taxpayers – use of data matching*, IGT, Sydney, 2013.

- taxpayers who called the ATO and case officers subsequently located existing evidence that supported the taxpayer's claim (12 cases);
- taxpayers contacting the ATO to advise that CGT income had been declared in a previous income year (10 cases);
- taxpayers contacting the ATO about an incorrect address, for example, a corner block residence or an incorrect or missing number for a unit block (eight cases);
- taxpayers who had never owned the property that was the subject of the letter (five cases);
- similar names meant letters were sent to the incorrect taxpayer (four cases);
- taxpayers that also received a letter the year before, which resulted in no further action (three cases); and
- a taxpayer claimed they did not receive the original letter before a notice of amended assessment was issued (one case).

**6.38** Overall, from the ANAO's sample of 377 cases, 43 cases (11 per cent) were identified where improved record keeping or relatively straightforward checking of taxpayer details by the ATO would have prevented letters being unnecessarily sent to taxpayers about CGT events. For these cases, conducting basic administrative checks would have saved time and resources for taxpayers and the ATO. As discussed in Chapter 4, to improve the quality of the cases being selected, the ATO introduced a manual scoping process for selecting compliance cases in April 2013, which was not fully reflected in the ANAO sample.

## **Compliance Effectiveness Methodology**

**6.39** In 2006, the ATO introduced a Compliance Effectiveness Methodology (CEM) to better measure the effectiveness of its compliance activities.<sup>160</sup> The CEM provides for the systematic evaluation of the impacts of compliance risk treatment strategies.<sup>161</sup> The CEM has four phases: risk identification; defining successful outcomes and developing compliance strategies; identifying and

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<sup>160</sup> The ANAO examined the application of the CEM in evaluating the effectiveness of key compliance activities and shaping the development of strategies to promote voluntary compliance. ANAO Audit Report No.39 2013–14 *Compliance Effectiveness Methodology*, p. 13.

<sup>161</sup> *ibid.*, p. 14.

testing indicators of success; and evaluating and reporting on the effectiveness of the compliance strategies in the short, medium and long term.<sup>162</sup>

**6.40** Deputy Commissioners in the Compliance Group are responsible for applying the CEM to high priority compliance risks. The SB/IT BSL has not undertaken a CEM evaluation for CGT. However, the ANAO's analysis of a CEM evaluation for CGT completed in PGH in 2012 agreed with the evaluation's conclusion of ineffective strategies, which was based on evidence that identified compliance threats were not being mitigated.<sup>163</sup>

**6.41** In recent years, ongoing issues with the use of third-party data to identify potential instances of non-compliance with individual taxpayers' CGT obligations, following the deferral of the 2013–14 Budget measure, have impacted on the effectiveness of that compliance activity. Additionally, there have been large reductions in revenue raised from CGT compliance activities for both individual and small business taxpayers and restructuring of CGT arrangements for conducting compliance activities for small businesses. In this light, the ATO should evaluate its CGT compliance strategy. In addition, given there is a new CGT risk covering multiple business areas (as discussed in Chapter 3), there is an opportunity for the ATO to conduct a CEM evaluation, to assess CGT compliance activities undertaken in all relevant market sectors, to confirm that its approach to compliance is effectively mitigating this risk.

## Recommendation No.1

**6.42** To determine the effectiveness of its capital gains tax (CGT) compliance strategies and activities, the ANAO recommends that the ATO:

- (a) undertakes an evaluation of the bulk mailout of letters to individual taxpayers for potential non-compliance with CGT obligations;
- (b) further assesses the effectiveness of CGT reviews and audits of small business taxpayers; and
- (c) conduct an evaluation for CGT that includes all the relevant market sectors using the Compliance Effectiveness Methodology.

**ATO response:** *Agreed.*

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<sup>162</sup> *ibid.*, p. 33.

<sup>163</sup> The ANAO examined whether the conclusions of 16 ATO compliance effectiveness evaluations were defensible. *ibid.*, p. 79.

## Objections

**6.43** The ATO conducts an internal review if an objection is lodged about decisions made by the ATO, including tax assessments. The Interpretive Assistance stream in SB/IT is responsible for determining the outcome of CGT objections.

### Objection outcomes for Capital Gains Tax

**6.44** In the previous three years, the ATO finalised 2031 objections in SB/IT relating to CGT matters in the individual and small business market segments. The 2031 objections comprised 1226 (60 per cent) individual taxpayer cases and 805 (40 per cent) small business cases. The outcomes from those objections are summarised in Table 6.6.

**Table 6.6: Capital gains tax objection outcomes, 2011–12 to 2013–14**

Outcome	2011–12	2012–13	2013–14
Allowed in full	213	318	417
Allowed in part	17	83	126
Disallowed	54	130	153
Invalid	28	63	70
Other	40	16	18
Withdrawn	41	115	129
<b>Total objections</b>	<b>393</b>	<b>725</b>	<b>913</b>

Source: ANAO analysis of ATO data.

**6.45** A total of 27 789 compliance cases for CGT (for individual and small business taxpayers) were finalised from 2011–12 to 2013–14. During the three-year period, the objection rate (cases finalised and objections finalised) for both market segments was 7.3 per cent.<sup>164</sup> Of the objections that were lodged, the ATO allowed in favour of the taxpayer either in full and in part for between 55–60 per cent of the objections for each year. The ATO advised that the most common reason recorded for allowing an objection (in full or in part) was the taxpayer providing new evidence. For DMCS, there is the potential for a further reduction in objections if the CGT discrepancy letters can elicit an earlier response from taxpayers, rather than waiting until the objection stage to provide

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<sup>164</sup> The objection rate is based on the total number of finalised cases and includes cases without a financial outcome.

their evidence.<sup>165</sup> The ATO was not able to identify a sole cause<sup>166</sup> for the increase in the number of objections each year, which does not directly correspond to an increase in the number of cases finalised.

**6.46** For the CGT objections finalised in Table 6.6, and allowed in full or in part, the ATO advised that the liabilities raised for the cases were all negative adjustments, in favour of the taxpayer, of: \$5.1 million in 2011–12; \$22.9 million in 2012–13; and \$18.4 million in 2013–14.<sup>167</sup>

**6.47** The ATO provides feedback from objections to compliance staff to help to improve taxpayers' experience of the audit and objection processes and to identify and seek to resolve issues that create unnecessary objections. For CGT compliance cases, the ATO advised that the feedback method used by Interpretive Assistance staff processing objections differs between DMCS and SBC, primarily due to the different volume of cases processed by each stream. Feedback from Interpretive Assistance staff can be provided at the case officer (if relevant), team or manager level. However, there is comparatively little direct case ownership in DMCS.

**6.48** Overall, DMCS and SBC CGT managers are responsible for monitoring and reporting to their respective Assistant Commissioners any trends or issues with objections that require further action by the compliance teams. The ATO advised that a Memorandum of Understanding was implemented in March 2015 between the Interpretive Assistance stream and the active compliance areas of SB/IT (including DMCS and SBC), which is intended to formalise the provision of feedback and advice on trends or issues that had occurred on a case-by-case basis. Given the impact on liabilities raised and cash collection that objections have across financial years, it will be important for the ATO to take into consideration the outcomes from objections when evaluating the effectiveness of CGT compliance activities.

## Timeliness of objections

**6.49** Under the ATO's service commitments, the 'timely' performance measure relevant to CGT objections work in the last three years is: 70 per cent of

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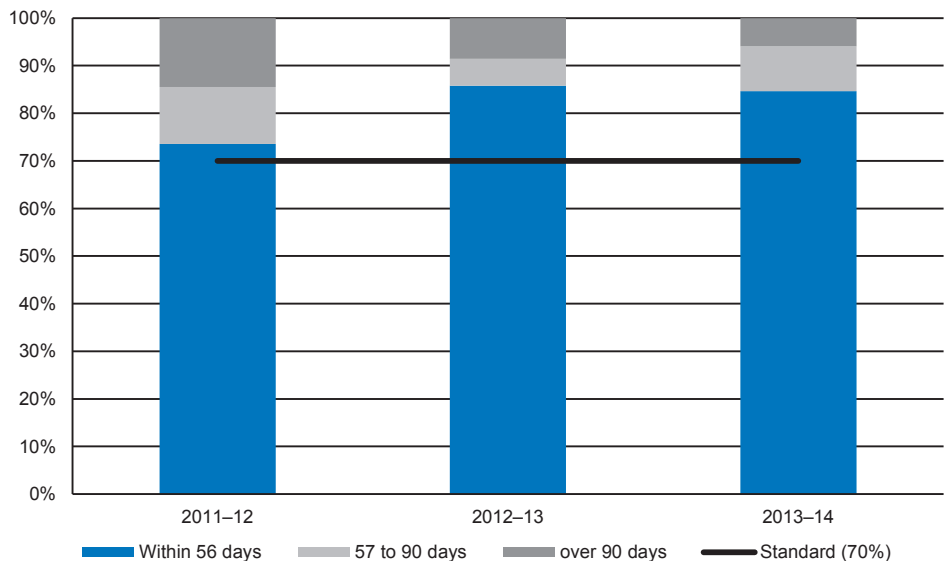
165 In 2014–15, the ATO advised that the DMCS objection rate for CGT cases was at 1.68 per cent in February 2015.

166 The ATO suggested that a possible cause of the increase in objections could be referrals from the debt area when the taxpayer could have lodged an application for debt relief instead of an objection.

167 The cases may not directly correspond to the CGT cases finalised from 2011–12 to 2013–14.

objections are finalised in 56 calendar days of receiving all necessary information.<sup>168</sup> The ANAO examined the timeliness of the objections finalised for CGT cases from 2011–12 to 2013–14 in both market segments, and the analysis is presented in Figure 6.1.

**Figure 6.1: Timeliness of capital gains tax objections, 2011–12 to 2013–14**



Source: ANAO analysis of ATO data.

**6.50** For the last three years, the ATO has met the measure for timeliness in all years. The range of days that elapsed after the ATO received all of the taxpayer’s information necessary to finalise an objection, was in: 2011–12, zero (same day) to 256 days; 2012–13, zero to 741 days; and 2013–14, zero to 382 days. The three cases that had the longest duration had the following characteristics:

- 256 days—complex case; objection allowed in full; and related to trusts and small business concessions for CGT;
- 741 days—routine case; objection allowed in part; and related to CGT and shares; and

168 ATO, *Access, accountability and reporting* [Internet], ATO, available from <<https://www.ato.gov.au/About-ATO/Access,-accountability-and-reporting/Our-commitments-to-service/Current-year-commitments-to-service/>> [accessed 20 January 2015].

- 382 days—complex case; objection was disallowed; and related to income and compensation.

**6.51** Overall, the rate of objections for CGT cases in DMCS and SBC has been low in the past three years and the decisions from objections have generally favoured taxpayers.

## Conclusion

**6.52** From 2011–12 to 2013–14, SBC finalised approximately 1400 cases (by review and audit) for small businesses selected for compliance activity, which, raised \$143.5 million in liabilities and collected \$33.6 million (almost 25 per cent). Compared to recent years, SBC intends to undertake only 32 CGT cases in 2014–15, with a target of \$13.1 million in liabilities to be raised. This is a significant decrease in the number of planned cases and potential liabilities for CGT. CGT work in 2014–15 will be included in SBC's comprehensive compliance cases for small businesses. For the 95 small business cases examined by the ANAO there was scope to improve the recording of the case context and case decisions, which would better support the planning and conduct of cases.

**6.53** DMCS conducts compliance cases for individual taxpayers using correspondence (letters that draw on third-party data). Since 2009–10, approximately 27 000 cases have been finalised using a series of bulk letter mailouts, which have raised approximately \$409 million in liabilities. The cash collected from 2011–12 to 2013–14, (after the two-year pilot) was \$114.8 million (29 per cent) of the liabilities raised in the three-year period. The ANAO examined a sample of 377 CGT cases finalised by DMCS in 2012–13 and 2013–14, of which 322 involved letters being sent to taxpayers. In 41 per cent of these cases, the ATO took further action. However, of the 82 cases with amended assessments, almost half had an administrative reversal that reduced the initial liability raised substantially.

**6.54** For 191 cases (59 per cent) examined by the ANAO, the ATO did not take any further action after sending the CGT letter, most commonly because letters were either returned to sender or no response was received from the taxpayer. Accordingly, the ATO should evaluate the current approach to the CGT letter strategy and identify ways to increase its effectiveness. The ATO should also review whether expected benefits have been realised through incorporating CGT into the broader reviews and audits of small business taxpayers. There would also be advantages, after finalising a CGT risk covering all market sectors,

in the ATO conducting a CEM evaluation to gain assurance that its approach to compliance is effectively mitigating this risk.

**6.55** The objection rate for CGT compliance cases, from 2011–12 to 2013–14, for individual and small business taxpayers was low (2031 finalised objections, or 7.3 per cent of finalised compliance cases). Over half of those objections were allowed in full or in part each year in the taxpayer's favour. SB/IT's timeliness performance for finalising CGT objections exceeded the ATO's corporate standard. From 2011–12 to 2013–14, more than 70 per cent of the objections were finalised in 56 calendar days of the ATO receiving all of the necessary information.

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Grant Hehir  
Auditor-General

Canberra ACT  
25 June 2015



# Appendices



## Appendix 1 Entity Response



Australian Government  
Australian Taxation Office

11 JUN 2015  
9:30

Second Commissioner of Taxation

Ms Barbara Cass  
~~Group Executive Director~~  
Performance Audit Services Group  
Australian National Audit Office  
GPO Box 707  
CANBERRA ACT 2601

11/6/2015

Barbara  
Dear Ms Cass

Thank you for your letter dated 14 May 2015 and for the opportunity to provide comments on the proposed audit report on the *Administration of Capital Gains Tax for Individual and Small Business Taxpayers*.

We are pleased that the audit report found the ATO's compliance approach toward the administration of CGT to be generally effective.

We wish to make a comment regarding your finding that CGT revenue targets have not been met in recent years. The Global Financial Crisis (GFC) had an impact on the revenue targets. Many of the potential gains that relate to assets that were disposed of were not able to be realised following the GFC in both the individual and small business markets. We appreciate that you have recognised the volatile nature of CGT revenue due to market forces.

We also would like to recognise that significant improvements have been made to our processes for CGT in the individual market segment. Using a variety of new data matching techniques, such as cross matching against other data sources and reviewing prior year results, strike rates have improved over the three year period from 47% to 70%. This has also resulted in better targeted and reduced volumes of letters issuing to the community.

The ATO agrees with the one recommendation made in the proposed audit report.

Attached is the ATO response to recommendation (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 audit. I look forward to continuing the good working relationship developed in this performance audit.

If you require further information on this audit, please contact Steve Vesperman, Deputy Commissioner, Small Business and Individual Taxpayers on 02 62161080.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Neil Olesen', with a stylized, cursive script.

Neil Olesen  
Second Commissioner  
Australian Taxation Office

Date: 05 June 2015

## Appendix 2      **Recommendations from ANAO Audit Report No.16 2006–07 *Administration of Capital Gains Tax Compliance in the Individuals Market Segment***

At the time of the previous ANAO audit, in 2006–07, the ATO was over half way through implementing a four-year CGT project that started in July 2004 and focused on capital gains arising from real property and share disposals.

For the current audit, when assessing the implementation status of each of the previous ANAO audit’s seven recommendations, the ANAO:

- considered the original intended outcome for that recommendation;
- reviewed the documentation provided by the ATO; and
- considered relevant evidence collected during audit fieldwork.

The ANAO did not examine the governance arrangements in place to monitor and oversee the implementation of the recommendations. Table A.1 sets out the categories of implementation used to assess the seven recommendations.

**Table A.1:      ANAO categories of implementation**

Category	Explanation
Adequate implementation	The action taken met the intent of the recommendation, and sufficient evidence was provided to demonstrate action taken.
Partial implementation	<p>This category encompasses three considerations:</p> <ul style="list-style-type: none"> <li>• action taken was less extensive than recommended by the ANAO. Action either fell short of the intent of the recommendation, or only addressed some of the identified risks;</li> <li>• the entity may have established a process or procedure to address an issue, however, the specific action noted in the recommendation was not complete at the time of the assessment; and</li> <li>• the entity may have commenced action to address a recommendation, but subsequent policy changes may influence how it might be implemented.</li> </ul>
Not adequate implementation	<p>This category encompasses two considerations:</p> <ul style="list-style-type: none"> <li>• there is no supporting evidence that action has been undertaken; and</li> <li>• the action taken does not address the recommendation.</li> </ul>

Source: ANAO Audit Report No.8 2014–15 *Implementation of Audit Recommendations*, p. 46.

Table A.2 contains the:

- seven recommendations from ANAO Audit Report No.16 2006–07 *Administration of Capital Gains Tax Compliance in the Individuals Market Segment*;
- ATO's response; and
- ANAO's categorisation of the implementation status and commentary.

The ANAO has previously observed that there is a link between the value realised from a performance audit and the appropriate and timely implementation of recommendations.<sup>169</sup> The ATO advised that the seven recommendations were fully implemented between June 2007 and March 2010. The recommendations, which were being monitored by Internal Audit in the ATO, were subsequently closed.

The ANAO's analysis shows that the ATO adequately implemented all seven of the recommendations from the previous ANAO audit report. The ATO demonstrated that appropriate action was taken for each recommendation to improve the administration of CGT in the individuals market segment.

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169 ANAO Audit Report No.8 2014–15 *Implementation of Audit Recommendations*, p. 11.

**Table A.2: Implementation status of previous audit recommendations**

Recommendation	ATO response	Implementation status	ANAO comment
<p><b>Recommendation No.1</b></p> <p>The ANAO recommends that CGT project planning be improved at the operational level by:</p> <ul style="list-style-type: none"> <li>• preparing a CGT project Delivery Plan annually with clear links to relevant priorities, outcomes and risks identified in strategic level plans and performance measures that enable assessment of progress against the project's intended outcomes; and</li> <li>• linking the planning documents for the ATO's various operational streams to the CGT project Delivery Plan in accordance with relevant ATO practice statements.</li> </ul>	<p>The Tax Office agrees with this recommendation.</p> <p>The Personal Tax business line developed a Business Line Plan that included all activities for 2005–06. For 2006–07 the Micro Enterprises and Individuals business line will bring together the relevant outputs to form a Capital Gains Tax Project Plan.</p> <p>The integrated Capital Gains Tax Project Plan will highlight key outputs at the overall Project level and at the business line and stream level. It will be modelled on the 2004–05 plan, providing clear linkages between Project deliverables and business line stream deliverables.</p>	<p>Adequate implementation</p>	<p>The ATO advised that, following a workshop with key stakeholders for the delivery of CGT in 2007–08, stream plans were developed in the former Micro Enterprises and Individuals BSL that reflected the work discussed. A document setting out CGT work across the BSL was also prepared.</p> <p>Further, the CGT project was time limited (four years) and planning for CGT is now embedded as business-as-usual in SB/IT.</p>

Recommendation	ATO response	Implementation status	ANAO comment
<p><b>Recommendation No.2</b></p> <p>The ANAO recommends that the ATO, based on the outcomes of the data management activities initiated as part of the CGT project, assess the need to implement changes or additions to the level of information disclosure required in respect of the capital gain and loss components in the individual income tax return, having regard to the cost of compliance.</p>	<p>The Tax Office agrees with this recommendation.</p> <p>To date, the Tax Office has focused compliance activities on those who do not include any capital gains tax amounts on their income tax returns. The Tax Office will consider return form changes as it broadens its' compliance focus.</p>	<p>Adequate implementation</p>	<p>The ATO advised that, following a review, proposals to change the tax return for CGT were unsuccessful in 2009 and 2010 (due to higher corporate priorities).</p> <p>In 2012, the ATO undertook a review of business income tax returns in an effort to obtain a better balance between the community's cost of compliance and the organisation's information needs.</p> <p>The review resulted in a redesign of the CGT schedule in 2013.</p>
<p><b>Recommendation No.3</b></p> <p>The ANAO recommends that the ATO regularly report back any significant errors or defects identified in the real property data provided by an Office of State Revenue.</p>	<p>The Tax Office agrees with this recommendation.</p> <p>This is an important feedback mechanism, and the Tax Office has already provided both the Offices of State Revenue and the Land Titles Office with reports regarding the initial data. In the 2006–07 Capital Gains Tax Project Plan, one of the outputs is regular feedback reports on data received.</p>	<p>Adequate implementation</p>	<p>The ATO advised that, in 2007 at a meeting of the Australian Tax and Revenue Offices (ATRO) forum, the Commissioners were advised that the property data exchange was working well, with exceptions being minimal and under control.</p> <p>Currently, the ATO provides feedback to state and territory governments about any issues identified with real property data through an ATRO Property Working Group or directly between individual state and territory government and ATO officials involved in the management of third-party data.</p>



Recommendation	ATO response	Implementation status	ANAO comment
<p><b>Recommendation No.4</b></p> <p>The ANAO recommends that the ATO, based on the outcomes of the data management activities undertaken for the CGT project:</p> <ul style="list-style-type: none"> <li>• assess whether, of the options available, automated data matching and case actioning is the most appropriate strategy to achieve capital gains tax compliance in the individuals market segment; and</li> <li>• review the need to explore other solutions with relevant state and territory Government Revenue and Land Titles offices that support the quotation of key identifiers at the time of real property disposal or acquisition.</li> </ul>	<p>The Tax Office agrees with this recommendation.</p> <p>It is part of the overall strategy to determine the feasibility of automated data matching and case actioning for Capital Gains Tax compliance in the individuals' market segment at the completion of the project. The Tax Office is involved in regular discussion with state and territory Government Revenue Offices. The Tax Office will continue to explore options for solutions via these discussions, including expanded data capture or the use of a unique identifier for real property transactions.</p>	<p>Adequate implementation</p>	<p>The ATO advised that an ATRO sub-committee was focusing on data integrity improvements, and would continue to do so in the future. The current ATRO Property Working Group fulfils this function. In 2008 and 2009, the ATO recommended to the Treasury the inclusion of tax file numbers in other data sets, including property data.</p> <p>As discussed in this audit, the ATO is currently working on the implementation of a 2013–14 Budget measure, <i>Tax compliance—improving compliance through third-party reporting and data matching</i>.</p> <p>The measure, which is currently scheduled to commence from 1 July 2016 with the introduction of new reporting regimes, is designed to improve taxpayer compliance by enhancing the information reported to the ATO by a range of third parties.</p>

Recommendation	ATO response	Implementation status	ANAO comment
<p><b>Recommendation No.5</b></p> <p>The ANAO recommends that to provide assurance that real property active compliance interactions planned for the CGT project achieve an acceptable risk based level of national coverage, future plans should demonstrate suitable linkages to the real property sales population being reviewed and consistency in the period being analysed.</p>	<p>The Tax Office agrees with this recommendation.</p> <p>The intent of the Tax Office's strategy is to take a national approach, acquiring real property transaction data from all states and territories.</p> <p>Research and intelligence will inform the Tax Office understanding of the market in real property and case selection will be based on risk.</p>	<p>Adequate implementation</p>	<p>The ATO advised that, by June 2007, real property data was available for all states and territories and was being used to select cases for the 2007–08 compliance activities.</p> <p>In 2014–15, during audit fieldwork, the ANAO confirmed the acquisition of real property data from state and territory: revenue offices, land titles registries, and tenancy authorities. The data is used across the ATO for educative and active compliance projects relating to: income tax, CGT, and the goods and services tax.</p>
<p><b>Recommendation No.6</b></p> <p>The ANAO recommends that to assist with the assessment and treatment of CGT compliance risks identified in respect of Annual Investment Income Report (AIIR) data, the ATO:</p> <ul style="list-style-type: none"> <li>analyse relevant data, in the related period of review, reported by unit trusts on capital gains distributed to individuals; and</li> <li>subject to a risk assessment, incorporate unit trust distributions as part of the active compliance interactions planned for the remainder of the CGT project.</li> </ul>	<p>The Tax Office agrees that Capital Gains Tax compliance risks identified in Annual Investment Income Report data will be risk assessed along with all other risks. The cases rated as higher risk will be addressed.</p>	<p>Adequate implementation</p>	<p>The ATO advised that unit trust distributions were included as part of the <i>2007–2008 Capital Gains Tax Compliance</i> plan. A formal risk assessment was completed in conjunction with Risk and Information Management Services. High risk cases were to be actioned in accordance with the high to severe risk ranking.</p> <p>The recommended timing for implementation of the recommendation was during the remainder of the CGT project, which was to finish around 2008. In November 2007, the ATO finalised a compliance risk assessment for CGT unit trust distributions relating to individual taxpayers.</p> <p>In 2015, the ATO advised that AIIR data includes managed fund distribution data, including distributed</p>

Recommendation	ATO response	Implementation status	ANAO comment
			capital gains. This forms part of the partnerships, trusts and units work on income distributed from managed funds. Implementation of the Budget measure is expected to make available data on the sale of units in managed funds, which will further expand the CGT compliance work for managed funds.
<p><b>Recommendation No.7</b></p> <p>The ANAO recommends that the ATO, to inform future compliance planning, determine and document its methodology for setting the CGT project liabilities and cash collection targets, and consistently apply the cash collection rate to liabilities raised. This documented methodology should address business-as-usual and <i>compliance challenges</i> targets.</p>	<p>The Tax Office agrees with this recommendation.</p> <p>A document outlining the methodology to establish project and cash collection targets will be compiled.</p>	<p>Adequate implementation</p>	<p>The ATO advised that an appropriate methodology was prepared and the recommendation was completed in 2007. While the ATO was unable to provide the original documentation from 2007, the ATO has in place a current <i>Active Compliance Collection Rate Method 2013–14</i>, which was described as being similar in nature to the 2007 methodology.</p> <p>The current methodology aims to determine cash collection rates on all active compliance work undertaken by the ATO in any financial year, which would include CGT. The ATO advised that the collection rates are used to calculate collection information published in the Commissioner of Taxation's annual report. The collection rates are also used for business line planning to estimate future collections for a particular BSL.</p>

Source: ANAO analysis of ATO documents.

## Appendix 3 Risk Analyses for Capital Gains Tax

Common features of SB/IT risk analyses for CGT	
Risk event	
<p>Taxpayers:</p> <ul style="list-style-type: none"> <li>• failure to lodge a tax return;</li> <li>• incorrectly claiming concessions or exemptions;</li> <li>• under-reporting or omission of CGT;</li> <li>• disclosed in incorrect year or entity;</li> <li>• incorrectly classifying events (revenue versus capital);</li> <li>• incorrectly creating, applying and calculating capital losses;</li> <li>• inadequate record keeping practices;</li> <li>• incorrectly applying cost base principles;</li> <li>• failure to advise tax professional of CGT events and subsequent CGT obligations; and</li> <li>• failure to correctly follow ATO view of the law.</li> </ul>	<p>Tax agent and other representatives:</p> <ul style="list-style-type: none"> <li>• failure to ask the right questions;</li> <li>• provide incorrect advice; and</li> <li>• mislabelling and incorrect reporting.</li> </ul> <p>External data agencies:</p> <ul style="list-style-type: none"> <li>• provide incorrect or incomplete data.</li> </ul>
Risk participants	
<p>Inside the tax system:</p> <ul style="list-style-type: none"> <li>• individuals;</li> <li>• sole traders;</li> <li>• companies;</li> <li>• trusts;</li> <li>• self-managed super funds; and</li> <li>• partners in a partnership.</li> </ul>	<p>Outside the tax system:</p> <ul style="list-style-type: none"> <li>• non-lodgers.</li> </ul>
Risk drivers	
<p>Taxpayers:</p> <ul style="list-style-type: none"> <li>• lack of awareness and understanding of obligations;</li> <li>• complexity of the law;</li> <li>• poor record keeping;</li> <li>• perceived low risk of detection and/or consequence; and</li> <li>• reduced taxation liability or monetary benefit or greed.</li> </ul>	<p>Tax agents and other representatives:</p> <ul style="list-style-type: none"> <li>• not keeping up-to-date with legislation or technology; and</li> <li>• time pressure.</li> </ul> <p>External data agencies:</p> <ul style="list-style-type: none"> <li>• IT system deficiencies;</li> <li>• cost of providing data;</li> <li>• competing priorities; and</li> <li>• variations in data formats between agencies.</li> </ul>

Source: ANAO analysis of ATO documents.

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