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Performance Audit

Managing Compliance of High Wealth Individuals

Australian Taxation Office

Australian National Audit Office

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Canberra ACT
4 June 2014

Dear Mr President
Dear Madam Speaker

The Australian National Audit Office has undertaken an independent performance audit in the Australian Taxation Office titled *Managing Compliance of High Wealth Individuals*. 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, appearing to read 'Ian McPhee', is positioned above the printed name.

Ian McPhee
Auditor-General

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

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Abbreviations

AAT	Administrative Appeals Tribunal
ANAO	Australian National Audit Office
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
ATOUCA	Australian Taxation Office Unit Cost Analysis
CEM	Compliance Effectiveness Methodology
HWI	High Wealth Individual
IQF	Integrated Quality Framework
KPI	Key Performance Indicator
NFA	No Further Action
OECD	Organisation for Economic Co-operation and Development
PGH	Private Groups and High Wealth Individuals
RAPT	Risk Assessment and Profiling Tool
RDF	Risk Differentiation Framework

Glossary

Advance pricing arrangement	An agreement between the ATO and the taxpayer that determines, on a prospective basis, the income tax treatment of specific international transactions over a fixed period, usually between three and five years.
Audit	Specific or wide-ranging ATO examination to confirm that the correct amount of tax has been paid. Usually follows a risk review (preliminary or comprehensive).
Aggressive tax planning	Aggressive tax planning arrangements take advantage of the technicalities of a tax system or mismatches between two or more tax systems to reduce tax liability.
Compliance effectiveness methodology	Measures the impact of the ATO's compliance strategies on treating specific compliance risks. The compliance effectiveness methodology is a workshop-centred approach based on two key elements: the identification of measurable compliance objectives; and the articulation and treatment of the risks to achieving these objectives.
Comprehensive risk review	Compliance activity involving the detailed analysis of a taxpayer's private and business activities to determine if identified risks require further explanation or treatment. Taxpayers are provided with an opportunity to respond to identified risk.
High wealth individuals	The ATO defines high wealth individuals as Australian residents who, together with associates, effectively control net wealth of \$30 million or more.
Integrated Quality Framework	The quality assurance process used by the ATO to improve and assure the quality of a range of activities, including audits and risk reviews.

Phoenix activity	The evasion of tax and/or superannuation guarantee liabilities through the deliberate, systematic and sometimes cyclic liquidation of related corporate trading entities.
Potential high wealth individuals	Australian residents, together with associates, whose estimated net wealth of \$30 million or more is yet to be confirmed.
Preliminary risk reviews	Compliance activity aimed at developing an understanding of a taxpayer's structure, business activities, tax affairs and risk profile to determine if further review is warranted. These are internal, may not involve contact with the taxpayer, and should not exceed 60 days to complete.
Risk differentiation framework	A compliance modelling tool that uses likelihood and consequence assessments to provide a relative risk profile of a specified population of taxpayers.
Wealthy Australian	The ATO defines wealthy Australians as Australian residents controlling a net wealth of \$5 million to \$30 million.

Summary and Recommendations

Summary

Introduction

1. The Australian Taxation Office (ATO) is responsible for administering Australia's taxation system. Based on self-assessment, the system relies on high levels of voluntary participation by taxpayers. The ATO's goal is to support people to understand their rights and responsibilities, and protect the community by deterring, detecting and dealing with those taxpayers who do not meet their obligations. For these taxpayers, including some high wealth individuals (HWIs), the ATO implements a range of compliance strategies that increase in intensity as taxpayers' willingness to comply decreases.
2. The ATO defines HWIs as Australian resident individuals who, together with their associates, effectively control an estimated net wealth of \$30 million or more.¹ In total, HWIs control significant wealth, estimated by the ATO to be in excess of \$500 billion in 2012–13. Despite HWIs' contribution to taxation revenue (\$1.4 billion in 2011–12) there is a perception among the wider population that the rich may not always pay their fair share of tax.
3. HWIs tend to have complex business arrangements, with their wealth spread across a group of closely-held companies and trusts, each of which is generally a separate taxpayer entity. They may maintain expensive lifestyles without relying on income in a conventional taxable form. Wealth can be accessed in a variety of ways such as through the sale of pre-capital gains tax assets, loans and the use of lifestyle assets owned by the group. Publicly-available information on HWIs is often limited, as private companies and trusts are not subject to the stock exchange disclosure requirements on public companies and not overly affected by Australian Securities and Investments Commission requirements.
4. To encourage HWIs to meet their taxation obligations and to minimise potential revenue losses, the ATO has had a particular focus on HWIs since 1996. By 2013, the ATO had identified approximately 2600 HWIs and 3700 potential HWIs², and reported that it had collected over \$3 billion in

1 ATO, *Tax Compliance for Small-to-Medium Enterprises and Wealthy Individuals*. The ATO uses the market value of assets to estimate the net wealth controlled by HWIs.

2 Potential HWIs are wealthy individuals who meet the ATO definition of a HWI but whose wealth estimate has yet to be confirmed ATO, *Highly Wealthy Individuals: 2013–18 overarching strategy*.

additional revenue as a result of the compliance activities conducted since 1996. Accordingly, while representing a relatively small number of individuals, HWIs are a key population group for the ATO in terms of revenue collected through active compliance activities.

5. The ATO uses two broad categories of compliance activities: voluntary compliance activities that encourage taxpayers and their representatives to understand and comply with their obligations³; and active compliance activities that seek to verify information or enforce taxation law. Active compliance includes three main types of activities:

- preliminary risk reviews, which do not generally involve contact with the taxpayer and seek to gain a better understanding of an individual's tax affairs to determine if a more in-depth review is needed;
- comprehensive risk reviews, which involve taxpayer contact and are a more detailed examination of the individual's tax affairs; and
- audits, which can be specific or wide-ranging examinations of an individual's tax affairs and can involve visits to the taxpayer's premises. Audits are generally more intensive and take longer to complete than a comprehensive risk review.

6. The ATO responds to HWI compliance risks through the Private Groups and High Wealth Individuals business line, which also has similar responsibility for not-for-profit organisations, medium businesses and wealthy Australians.⁴ This business line has conducted many active compliance activities involving HWIs, and has a target of conducting 500 audits and risk reviews in 2013–14. Approximately 300 staff will be involved in these active compliance activities.

7. The HWI compliance strategy is based on a risk-management approach that determines compliance activities according to the risks HWIs pose to the taxation system. The ATO uses a range of wealth and risk assessment tools, collectively referred to as the Risk Differentiation Framework (RDF)⁵, to help in

3 The ATO's strategy to improve voluntary compliance is to be transparent about its key areas of focus, to provide information and to engage with HWIs and their representatives. Key messages are disseminated through the ATO's compliance program, annual reports, speeches delivered by the Commissioner of Taxation and senior ATO executives, and the media.

4 Wealthy Australians are Australian residents controlling a net wealth of \$5 million to \$30 million.

5 The RDF is also used to identify the HWI population and determine differentiated levels of tax compliance risk.

the selection of those HWIs that will be subject to compliance activity. The RDF has also become an important medium for communicating the ATO's risk management approach to the HWI taxpayers, and was used to source almost all HWI compliance cases (94 per cent for the period December 2010 to September 2013).

8. In the 2012–13 Mid-Year Economic and Fiscal Outlook, the Government allocated \$390 million in additional funding to the ATO for further compliance activities. Approximately \$37 million of this funding was for the implementation of a new strategy *Engaging newly identified HWIs*, which aims to confirm that these newly identified HWIs meet their tax obligations.

Audit objective and criteria

9. The objective of the audit was to assess the effectiveness of the ATO's activities to promote tax compliance by high wealth individuals. To form a conclusion against this objective, the ANAO adopted the following high-level criteria:

- compliance activities were supported by effective business and administrative arrangements;
- compliance risks were identified effectively;
- compliance activities, and associated objections and reviews, were conducted effectively; and
- outcomes and objectives were achieved.

Overall conclusion

10. High Wealth Individuals pose considerable challenges to tax administrations around the world because of the complexity of their affairs and opportunity for aggressive tax planning⁶, their contribution to revenue, and the potential for their behaviour to influence perceptions of the integrity of the tax system. In Australia, the tax compliance of HWIs is considered by the ATO to represent a significant revenue risk. Providing assurance that HWIs meet their tax obligations is essential to protect Australia's revenue base and

6 Aggressive tax planning takes advantage of the technicalities of a tax system or of mismatches between the tax systems of two or more countries for the purpose of reducing tax liability.

maintain community confidence in the equitable administration of the taxation system.

11. The ATO has effectively carried out a range of activities and engaged with HWI taxpayers and their representatives to reinforce their understanding of, and promote compliance with, tax obligations. The ATO's engagement approach has been one of transparency about its key areas of focus, and it has disseminated extensive guidance material and information in relation to tax requirements. The ATO has also had a particularly extensive HWI active compliance focus, conducting audits and risk reviews⁷ of over 90 per cent of the population between 2009–10 and 2012–13 and collecting almost \$852 million as a result of these compliance activities (\$671 million from audits and \$181 million from risk reviews).

12. However, the results of these activities have not always been commensurate with the level of effort deployed by the ATO. Over the four-year period, 90 per cent of the cash collected was from 12 per cent of the audits and five per cent of the comprehensive risk reviews undertaken by the ATO.⁸ The majority of these audits (70 per cent) and comprehensive risk reviews (84 per cent) did not have a financial outcome.⁹ Going forward and in anticipation of a focus on a larger pool of HWIs (from 2600 to around 6300), there is scope for the ATO to improve its risk assessments to better target active compliance activities and reduce compliance costs for both HWI taxpayers and the ATO.

13. The ATO has recognised the need for improved risk identification and differentiation, and since 2004 has been developing and refining the HWI risk assessment tools, most recently the Risk Differentiation Framework (RDF). Despite acknowledged shortcomings, the RDF has been central to the implementation of the HWI compliance strategy. Between 2009 and 2013, 94 per cent of all cases selected for compliance intervention were identified using the RDF. The ANAO's analysis of the outcomes of HWI compliance

7 As previously noted, there are two main types of risk reviews: preliminary risk reviews, which do not generally involve contact with taxpayers; and comprehensive risk reviews, which involve contact with taxpayers and a more detailed examination of their tax affairs.

8 A relatively small amount of cash was also collected from preliminary risk reviews—\$3.6 million from five of 1812 completed preliminary risk reviews.

9 The ATO advised that the main purpose for undertaking a comprehensive risk review is to consider if an audit is warranted, rather than seeking to obtain a financial outcome. It is also important to note that additional cash may be collected in later years in respect of the liabilities raised from both audits and risk reviews, and that adjustments to losses may have a positive effect on future revenue collections.

activities has however indicated that the RDF has not always been effective in identifying higher risk cases. The analysis also indicated that there was little or no link between wealth and non-compliance within the HWI population. The ATO has advised that it is further refining the RDF, including by modifying the weighting of wealth, and will continue to assess its reliability in effectively differentiating risk within the HWI population. In this regard, it is important that the ATO analyses the outcomes of the compliance activities in order to assess the effectiveness of the RDF in identifying the highest risk HWIs as well as to test the validity of the risks that have led to the selection of compliance cases.

14. HWI compliance work is complex, dealing with intricate business structures and contentious tax issues, with little available public information. This often makes it difficult for the ATO officers undertaking HWI compliance work to reach readily agreed positions in a timely way. Almost 40 per cent of reviews and audits completed between 2009–10 and 2012–13 were not delivered within the scheduled cycle time.¹⁰ Audits in particular exceeded cycle times by 352 days on average, against an already long initial cycle time (of 730 days for the majority of cases).¹¹ Despite these timeframes to resolve cases, HWI taxpayers objected to the outcome of their reviews or audits in approximately 65 per cent of cases completed in 2011–12 and 2012–13. Half of these objections resulted in a positive outcome for HWIs; being allowed either in full or in part. In more than 50 per cent of the cases where an objection had been allowed or settled, ATO objections staff recorded that the original compliance decisions were at least partially incorrect, or the ATO had changed its interpretation of the law.

15. These high rates of successful objections, together with the large proportion of compliance cases without a financial outcome and frequent completion of cases well beyond target cycle times, highlight opportunities for improving the conduct of HWI compliance activities. The ATO acknowledges these opportunities and has initiatives underway to strengthen compliance practices through improving staff capability, better using technical support,

¹⁰ Cycle times refer to the elapsed timeframe for completion of a review or audit 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.

¹¹ For the period examined by the ANAO, preliminary risk reviews should have taken between 40 and 60 days; comprehensive risk reviews between 30 and 365 days, and audits between 180 and 1095 days. The current cycle times are: 60 days for preliminary risk reviews; 180 days for comprehensive risk reviews; and 730 days for audits.

promoting staff communication with taxpayers and reducing the number of aged cases. To more efficiently allocate compliance resources, it is also important that the Private Groups and High Wealth Individuals (PGH) business line better assesses the costs of HWI compliance activities and more accurately calculates the actual return on investment¹² from these activities.

16. The ANAO has made two recommendations aimed at improving the reliability of the RDF through analysis of active compliance outcomes; and improving resource allocation by having greater regard to compliance risk and financial return.

Key findings by chapter

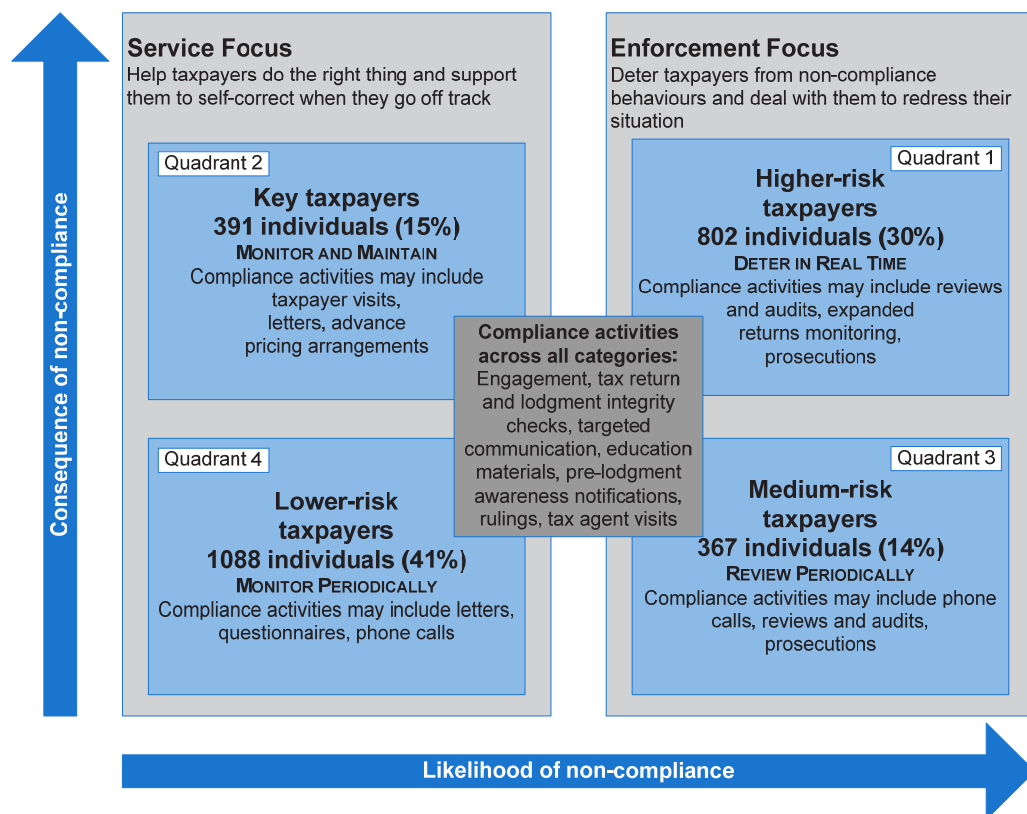
Assessing compliance risks (Chapter 2)

17. The ATO has used assessment tools (including risk engines, data mining and analytical models) to automate the identification and risk assessment of the HWI population since 2004. Three main tools contribute to the current HWI risk assessment process: the Group Wealth System, which calculates the net wealth of the entire taxpayer population; the Integrated Scoring Model, which extracts HWIs from the taxpayer population, assesses them against known risks, and applies a likelihood and consequences score to those risks; and the RDF, which provides a visualisation of the level of risk represented by each HWI taxpayer (Figure S1). The RDF was applied for the first time in the PGH business line in 2012 and is used by the ATO to guide the nature and intensity of its interaction with taxpayers.¹³

12 The ATO calculates the return on investment by dividing the total amount of liability raised (but not necessarily collected) through HWI compliance work by the average salary of the compliance staff involved in HWI compliance work, as further discussed in paragraph 31.

13 This report refers to the RDF to collectively describe the processes leading to the identification, risk assessment and scoring of the HWI population, rather than referring to the specific tools used in the process.

Figure S.1: ATO's Risk Differentiation Framework for HWIs, 2013



Source: ANAO, based on ATO, *Tax Compliance for Small-to-Medium Enterprises and Wealthy Individuals* and ATO, Minute to the PGH Risk Management Committee, 18 October 2013.

18. The ATO has developed a formal process to review existing risk rules and identify new rules. Three committees, each with separate responsibilities, oversee the identification of the population and development of risk rules underpinning the risk ratings assigned to HWI taxpayers.

19. Compliance teams, through their case work, are well positioned to validate existing risks and identify new risks, and their observations represent an important source of intelligence, including identifying areas of the law that may require clarification. The ATO released, in July 2013, a new intelligence framework, *ATOintelligence Discover*, which should enable more effective collection of intelligence from compliance teams. While there are review processes, there is no systematic quantitative analysis of the outcomes of the compliance activities, to assess if the compliance cases selected through the RDF process are the highest risk cases.

20. The information technology processes supporting the development of the RDF are relatively complex. These processes are characterised by a succession of steps, some manual and some automated, which necessitate repeated access to a range of internal and third party databases. While the control environment is not as mature as in other ATO systems, it is suitable for the context in which it operates, as the information produced is intended to be further analysed and filtered by downstream business processes. However, documenting the end-to-end process is likely assist in efforts to improve control over the quality of the information produced, as well as provide guidance to staff.

21. The RDF process is used by the ATO to determine the level of risk each HWI represents by assessing the relative likelihood of the individual being non-compliant and the consequences of that potential non-compliance. The ATO determined the boundaries between higher and lower risk HWIs on the basis of its available compliance resources and commitments, rather than in relation to an analysis of risk tolerance. Also, the algorithm used by the ATO to determine a HWI's position on the consequence axis of the RDF meant that wealth and business income contributed to 80 per cent of the HWI's consequence score, subsequently impacting the overall HWI risk rating. Analysis undertaken by the ANAO of the outcomes from compliance activities conducted between 2009–10 and 2012–13 indicated that there is little or no link between wealth and non-compliance within the HWI population.

22. There would be merit in the ATO testing the relationship between the other risk factors of the Integrated Scoring Model (including business income) and non-compliance, to assess whether the weightings attributed to these factors are sound. The ATO advised that work is being undertaken to determine fixed boundaries for the RDF, based on the level of risk that the ATO considers tolerable or intolerable. As part of this work, the ATO is also reviewing the weightings attributed to the different factors in the Integrated Scoring Model.

Compliance case selection (Chapter 3)

23. The aim of the case selection process is to provide compliance teams with a pool of the highest risk compliance cases, reflecting the ATO's HWI compliance strategy. Since January 2011, the selection of HWI compliance cases is coordinated by a single team, the National Case Selection team. This team coordinates the selection of compliance cases, initially using the RDF process,

and then manually assessing the RDF-identified cases to determine their priority for compliance activity. The establishment of a centralised case selection process supports a more systematic and robust process for selecting cases, and better alignment between the compliance strategy and active compliance resources and commitments.

24. Evaluating the effectiveness of the RDF process in selecting the highest risk compliance cases is essential to confirm that compliance resources are being used effectively, and to support continuous improvement processes. Accordingly, the ANAO examined 1445 cases assessed by the National Case Selection team between December 2010 and September 2013. The RDF was the primary source of cases selected for active compliance, representing 94 per cent of all cases assessed.¹⁴ In most years to September 2013, almost all cases were drawn from Quadrant 1, the highest risk quadrant. In 2011–12, the ATO drew 61 per cent of compliance cases from the lowest risk quadrant of the RDF (Quadrant 4). The ATO advised in May 2014 that these lower risk cases were selected because they had likelihood and consequence profiles that were similar to the higher risk cases in Quadrant 1. The ATO missed this opportunity to compare compliance outcomes from cases selected from different quadrants to assess the effectiveness of the RDF.

25. The ANAO used two key indicators to assess the effectiveness of the RDF process in selecting cases that present the higher risk (likelihood and consequences) of non-compliance:

- cases drawn from the RDF are either not actioned or directed to compliance by the National Case Selection team¹⁵: the proportion of cases not actioned can be expected to reduce over time, reflecting the continuous improvement to the RDF process, and be smaller for cases categorised as higher risk cases. Conversely, the proportion of cases accepted for compliance activity should increase over time and be larger for cases categorised as higher risk cases. However, the proportion of cases not actioned and cases accepted for compliance has remained constant since 2011–12 and remained similar for higher and lower risk cases; and

¹⁴ Other sources include referrals from internal and external intelligence.

¹⁵ Two outcomes are possible for cases considered in the selection process: not actioned, if the case selection teams consider that the compliance risks presented by the case were not sufficiently high or if the case was selected by the RDF in error; or sent to active compliance to be submitted to a risk review.

- active compliance escalation rate¹⁶: escalation can indicate that the initial selection of the case was successful, as the compliance risks were confirmed. The escalation rate can be expected to be higher for higher risk cases than for lower risk cases. However, the categorisation of a case as higher or lower risk through the RDF did not impact on the decision by active compliance teams to escalate the case for more intensive examination.

26. These results raise issues about the effectiveness of the RDF process in selecting the highest risk cases and emphasise the importance of the ATO regularly assessing the RDF risk factors.

27. In response to a recommendation from the Inspector-General of Taxation¹⁷, the ATO initiated a review of its risk assessment processes. Five measures were developed.¹⁸ One of these measures, the risk rule confirmation rate, which compares the risks identified through the RDF process to the risks confirmed, not actioned or newly identified by the compliance officer, yielded particularly useful information on the effectiveness of some of the risks. The ATO advised that this information was used to improve the RDF. There would be benefit in the ATO continuing to collect and analyse this performance data.

Conducting compliance activities (Chapter 4)

28. The ATO effectively engaged with HWI taxpayers and their representatives to gain assurance that they are aware of their tax rights and obligations. The ATO website makes available HWI-specific information and resources, including information on the ATO's compliance strategy, and legal and policy information (through the ATO Legal Database also accessible from the ATO website). Senior ATO executives have also engaged directly with

16 A case is escalated when it is moved from a lower intensity compliance activity, such as a comprehensive risk review, to a higher intensity activity, such as an audit.

17 Inspector-General of Taxation, *Review into the ATO's compliance approaches to small to medium enterprises with annual turnovers between \$100 million and \$250 million and high wealth individuals*, December 2011, p. 72.

18 The five measures were: strike rate (ratio of audits which reached a financial outcome to total audits completed); escalation rate; analysis of 'no further action' cases (cases that were not deemed to warrant further investigation and did not reach a financial outcome); National Case Selection panel validation rate (ratio of cases drawn from the RDF and subsequently validated by the case selection panels as worthy of further investigation by the compliance area); and risk rule confirmation rate (ratio of risks identified through the RDF and subsequently confirmed by the compliance area, to risks identified through the RDF).

HWI taxpayers and their representatives in numerous forums; and general and specialised publications have relayed the ATO's message.

29. As previously discussed, the ATO has conducted a large number of audits and reviews that generated \$852 million in cash collections between 2009–10 and 2012–13. In conducting these activities, the ATO has covered a large proportion of the HWI population (over 90 per cent). However, for the majority of cases (70 per cent of audits and 84 per cent of comprehensive risk reviews), there was no financial outcomes.

30. Between 2009–10 and 2012–13, almost 40 per cent of audits and reviews were not completed within the allocated cycle time. Audits that did not meet the cycle time standard exceeded it by an average of 352 days; comprehensive risk reviews by an average of 152 days; and preliminary risk reviews by an average of 65 days. Exceeding cycle times, especially for compliance activities that already have a long completion time such as audits, generates management challenges for the ATO, and extends the compliance burden for the taxpayer.

31. In a context of reduced ATO resourcing, it becomes even more important for the ATO to determine where the most effective compliance effort should be directed. Currently, the ATO determines its return on investment by dividing the total amount of liability raised through HWI compliance work by the average salary of the compliance staff involved. A more accurate measure would be to use the amount of cash collected, in addition to the liabilities raised. In 2012–13, the return on investment for HWI compliance activities was \$27 for each dollar spent based on liabilities raised, but only \$7 when based on cash collected. Further, the ATO does not currently calculate the cost of HWI compliance activities, and does not compare these with other populations in the business line. Assessing the cost of compliance activities for the HWI population could enable the ATO to more efficiently allocate compliance resources across the PGH business line.

32. The ANAO reviewed the management of HWI compliance cases by examining a sample of 244 comprehensive risk reviews and audits finalised between 2009–10 and 2012–13. There were some weaknesses in the recording of key documents and approvals in the ATO's electronic case management system. While active compliance staff indicated that they considered the case management system to be inflexible, slow, and generating duplication, it is important that key case documentation and approvals are recorded. Direct engagement and communication with HWI taxpayers and their representatives

is encouraged by the ATO and greatly appreciated by the HWIs' representatives. However, it did not take place as systematically as prescribed in ATO processes, or as desired by HWI representatives, in the cases reviewed by the ANAO.

Objections and appeals (Chapter 5)

33. The law gives taxpayers the right to object to ATO decisions when a taxpayer has been issued with an amended assessment following a compliance activity. When this occurs, the ATO conducts an independent internal review. The ATO aims to complete its review of the objection within 56 calendar days. If taxpayers disagree with the result, they are able to apply to the Administrative Appeals Tribunal or the Federal Court of Australia for an independent external review.

34. Approximately 65 per cent of compliance decisions (123) resulted in an objection in 2011–12 to 2012–13, of which almost half (49 per cent) gained a positive outcome for HWI taxpayers. For a large proportion of cases allowed in full or in part (45 per cent), new facts and evidence were introduced after completion of the compliance activities. However, for the remainder (55 per cent), the ATO recorded that the compliance decisions were at least partially incorrect, or that the ATO had changed its application of the law.

35. More than one in three HWI objections finalised between 2011–12 and 2012–13 required more than a year to complete. For those HWI taxpayers who object to their amended assessment, the time taken to determine an objection adds to the time taken to finalise the audit or review. Typically this will mean that taxpayers will be uncertain about their tax liability for over one thousand days for audits and over 600 days for reviews.¹⁹

36. Delivering soundly-based compliance decisions is both a priority and a desired outcome for the ATO, especially given the considerable time and resources expended on HWI compliance activities. Objection data suggests that, despite the time taken to complete compliance work, a substantial proportion of objections were allowed because the initial compliance decision was at least partially incorrect. The ATO advised that tax adjustments for HWIs often relate to complex, contentious and grey areas of the law. In this

¹⁹ Audits required on average 716 days to complete; and comprehensive risk reviews on average 250 days to complete, added to the average 352 days to determine an objection.

light, the work being undertaken by the ATO to improve the capability of compliance staff, and the increased use of alternative dispute resolution processes, may have a positive effect on active compliance timeframes and outcomes.

Measuring compliance effectiveness (Chapter 6)

37. Since 2008, the ATO has used a compliance effectiveness methodology (CEM) to measure the impact of its compliance strategies on treating specific compliance risks. The methodology is an iterative, workshop-centred approach based on two key elements: the identification of measurable compliance objectives; and the articulation and treatment of the risks to achieving these objectives.

38. The ATO has undertaken a CEM evaluation of HWI compliance activities on three occasions (2007, 2009 and 2012), and is planning for another evaluation in 2014. The 2012 iteration of the CEM was largely a refresh of the previous approaches, with some refinements to the success goals and effectiveness indicators. None of the three completed evaluations reached a firm conclusion as to the overall effectiveness of compliance activities in addressing HWI compliance risks, although the Chair of the Risk Management Committee observed that the compliance strategies were ‘heading in the right direction’.

39. The indicators used for the 2012 CEM implementations addressed key elements of the effectiveness of the ATO’s strategies to address HWI compliance risks, covering trends in voluntary compliance, outcomes from active compliance activities and community confidence levels. However, there were no indicators relating to interpreting the legislation to reduce potential lack of clarity in the application of the law by taxpayers and minimising aggressive tax planning. Further, the indicators did not adequately use information that could be obtained from the extensive programs of HWI audits and risk reviews, or from the risk assessment tools. In this regard, the evaluations could have analysed the results from active compliance activities, including the number of compliance cases resulting in an amended assessment and the relative scale of those returns. Such analysis could have facilitated the identification of more substantial opportunities to improve risk assessments, case selection and active compliance strategies and treatments.

40. There is limited external reporting of the results of HWI compliance activities. The ATO does monitor performance and report internally, particularly against deliverables such as revenue and other active compliance targets (including the number of compliance cases, liabilities raised and cash collected). Internal monitoring and reporting of HWI performance was examined in an ATO review of internal reporting arrangements within the PGH business line that was completed in February 2014. The ATO advised that as a result of the review, the reporting was more consistent, streamlined and reliable. The review also identified opportunities for consolidating the business line's reporting capabilities, which were still being considered for implementation at the time of this audit.

Summary of agency response

41. The ATO provided the following response to the audit report, with the formal response at Appendix 1.

The ATO welcomes this report. In finding the ATO's compliance approach to be generally effective, the review recognises the challenges that the ATO has in managing tax compliance of HWIs. Such challenges include complex business arrangements, opportunities for aggressive tax planning, intricate structures, contentious tax issues, grey areas of the law and limited public disclosure of financial information.

While the review focused on the four years to 30 June 2013, the ATO has made a number of significant improvements to its work in this area over the last 12 months.

We acknowledge there are further improvements to be made and the two recommendations will further assist with our improvements in this area.

Recommendations

Recommendation No. 1

Paragraph 3.29

To improve the reliability of the Risk Differentiation Framework (RDF), the ANAO recommends that the ATO analyses the outcomes of active compliance cases to assess the effectiveness of the RDF process in identifying those HWI taxpayers at higher risk of non-compliance.

ATO response: *Agreed.*

Recommendation No.2

Paragraph 4.43

To enable the ATO to more efficiently allocate compliance resources across the Private Groups and High Wealth Individuals business line, and to more accurately demonstrate return on investment, the ANAO recommends that the ATO:

- (a) better assesses the cost of compliance activities for the HWI population; and
- (b) calculates the return on investment for HWI compliance activities on the basis of cash collected, in addition to liabilities raised.

ATO response: *Agreed.*

Audit Findings

1. Background and Context

This chapter provides background information on the Australian Taxation Office's compliance approach to high wealth individuals. It also outlines the audit approach, including the objective, criteria, scope and methodology.

The Australian Taxation Office's approach to managing taxpayer compliance

1.1 The primary goal of the Australian Taxation Office (ATO) is to 'nurture, support, protect and champion an environment conducive to high levels of willing participation in Australia's tax and superannuation systems'.²⁰ High levels of voluntary participation are essential to protect Australia's taxation revenue base and maintain community confidence in the equitable administration of Australia's tax and superannuation systems.

1.2 While over 90 per cent of net tax collections are received voluntarily from the community, a proportion of taxpayers are either unable or unwilling to comply.²¹ In order to influence these taxpayers to meet their tax obligations, the ATO implements a compliance approach that uses differentiated strategies based on the attitudes of different groups of taxpayers and their advisers.

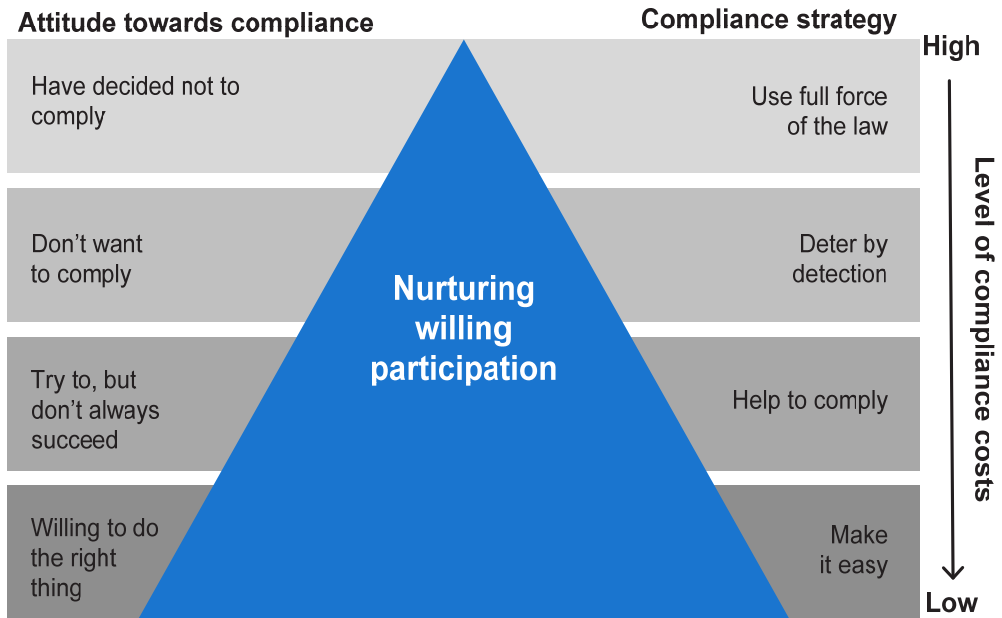
1.3 The compliance strategies implemented by the ATO increase in intensity as the taxpayer's willingness to comply voluntarily decreases (Figure 1.1). For instance, the ATO provides online tools such as e-tax, calculators, guides and advice on technical matters to assist those taxpayers who are willing to comply. At the other end of the compliance spectrum, the ATO takes action in the form of reviews, audits and, if necessary, prosecution for non-compliant taxpayers.²²

20 ATO, *Measure for Measure: The Four Pillars of Compliance*, Commissioner's speech at the CEDA Trustees Round, Melbourne 25 February 2011, available from <http://www.ato.gov.au/corporate/content.aspx?doc=/content/00277345.htm> [accessed 12 April 2013].

21 ATO, *Commissioner of Taxation Annual Report 2012–13*, p. 41.

22 ATO, *Compliance in focus 2013-14*, pp. 3-4, available from <http://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/General-statistics/Compliance-in-focus-2013-14/> [accessed 12 December 2013].

Figure 1.1: ATO compliance model



Source: ATO.

1.4 The compliance model provides the framework for developing compliance strategies across the ATO's market segments, and is particularly useful for smaller businesses and individual taxpayers, including high wealth individuals (HWIs).

High wealth individuals

1.5 HWI taxpayers are defined by the ATO as Australian resident individuals who, together with their associates, effectively control an estimated net wealth of \$30 million or more.²³ At October 2013, the ATO had identified approximately 2600 HWIs and an additional 3700 potential HWIs.²⁴ Potential HWIs are wealthy individuals who meet the ATO's definition of a HWI but whose wealth estimate has yet to be confirmed. In 2011–12, the 2600 identified HWI taxpayers collectively paid \$1.4 billion in net tax (Table 1.1).

²³ ATO, *Tax Compliance for Small-to-Medium Enterprises and Wealthy Individuals*, available from <http://www.ato.gov.au/About-ATO/About-us/In-detail/Key-documents/Tax-compliance-for-small-to-medium-enterprises-and-wealthy-individuals/?default=&page=16#Profile_of_the_small_to_medium_enterprises_market> [accessed 11 December 2013]. The ATO uses the market value of assets to estimate the net wealth controlled by HWIs.

²⁴ ATO, *Highly Wealthy Individuals: 2013–18 overarching strategy* [internal document].

Table 1.1: Net tax paid by HWIs and other individual taxpayers, 2010–11 to 2012–13

	2010–11	2011–12	2012–13
Tax returns lodged by individuals (\$ million)	12.6	12.7	13.5
HWIs identified by the ATO (approximate number)	2600	2600	2650
Tax collections from total individuals (\$ billion)	132.7	148.4	156.3
HWI individuals net tax (\$ billion)	1.6	1.4	Not available

Source: ANAO analysis of ATO documents.

1.6 Despite HWI taxpayers' significant contribution to taxation revenue, there is a perception amongst the wider population that the rich may not always pay their fair share of tax.²⁵ HWIs control significant wealth; in 2012–13, the 2650 identified HWIs had an estimated wealth of \$301 billion and the 3700 potential HWIs a further \$212 billion. Nevertheless, the ATO identified that in 2010 five per cent of HWIs paid no tax. In this context, it is important that the ATO takes effective measures to minimise the potential revenue loss from non-compliant HWI taxpayers. Figure 1.2 outlines the characteristics attributed to the HWI population.

²⁵ See, for instance, the Sydney Morning Herald's article citing 70 individuals with incomes of more than \$1 million who paid no income tax in 2010–11. Colebatch T., *The 70 mega rich who don't pay tax*, Sydney Morning Herald, 7 May 2013, available from <http://www.smh.com.au/opinion/political-news/the-70-mega-rich-who-dont-pay-tax-20130506-2j3ng.html> [accessed 15 May 2013].

Figure 1.2: Characteristics of the HWI population

The Organisation for Economic Co-operation and Development (OECD) uses the term 'high net worth individuals' to refer to individuals at the top of the wealth or income scale (generally above the threshold of US\$1 million in wealth or assets). A sub-segment of this population is the 'ultra high net worth individuals', who in Australia are referred to as HWIs and control \$30 million or more in financial assets. These individuals pose significant challenges to tax administrations because of the complexity of their affairs, their revenue contribution, the opportunity for aggressive tax planning¹ and the impact of their behaviour on the integrity of the tax system.

HWIs tend to have complex business arrangements, with their wealth spread across a group of closely-held companies and trusts, each of which is generally a separate taxpayer entity. Consequently, a HWI's tax compliance can often only be appreciated when their group, in which they have a key decision-making role, is considered as a whole. Family members will often hold positions within the group, which means that personal events such as death or divorce can have tax consequences, for example by triggering a capital gains tax event.

Groups typically comprise many different entity types, each serving a unique place in the business organisation because of its tax and business attributes. They typically contain the family business and significant real estate (both commercial and private). Private and business interests are often mixed, and in many cases the wealth is the legacy of generations of business success, with significant long-term assets acquired before the introduction of capital gains tax.

HWIs may maintain expensive lifestyles without relying on income in a conventional taxable form. Wealth can be accessed in a variety of ways such as through the sale of pre-capital gains tax assets, loans and the use of lifestyle assets owned by the group.

Publicly-available information on HWIs is often limited, as private companies and trusts are not subject to the stock exchange disclosure requirements on public companies and not overly affected by Australian Securities and Investments Commission requirements.

The ATO has identified that the situation of a HWI in the 'business life cycle' has a significant impact on tax risk. The highest income tax risks tend to arise in the early stages of the cycle when wealth is created and maintained, whilst the focus is likely to shift to inheritance, estate and gift tax planning as the HWIs consider plans for the succession to their wealth. Some HWIs, especially in the wealth-creation phase, may not seek the level of professional advice appropriate to the complexity of their tax affairs and this further increases the tax risk. When an individual has built up a level of wealth they often become more conservative in their approach to tax risk.

Source: OECD, *Engaging with high net worth individuals in tax compliance*, 2009; and ATO, *Wealthy and wise: a tax guide for Australia's wealthiest people*, 2008.

Note 1: Aggressive tax planning arrangements take advantage of the technicalities of a tax system or mismatches between two or more tax systems in order to reduce tax liability.

HWI tax compliance arrangements

HWI taskforce

1.7 Australia was one of the first countries to establish a dedicated and specialised unit to monitor HWIs.²⁶ In 1996, the ATO identified a small group of taxpayers with an estimated net wealth of over \$30 million who, individually, had taxable income of less than \$20 000.²⁷ The ATO estimated that the tax compliance behaviour exhibited by these taxpayers could place at risk up to \$800 million of revenue per year. In order to gain a better understanding of the tax arrangements used by HWIs, and ultimately improve the level of participation in the tax system of this specific taxpayer group, the ATO established a HWI taskforce. The taskforce operated on a client ownership model under which individual compliance officers were allocated responsibility for monitoring and conducting compliance activities on specific HWI taxpayers. The taskforce treated the individual returns of a HWI and the entities they controlled as a single case.²⁸

1.8 The affairs of HWIs are likely to be substantially more complex than those of other taxpayers, with issues of foreign income and foreign residence, income originating from a variety of sources, and complex business arrangements across a number of closely-held private groups. Recognising the HWI as the controlling mind for all of these entities, and understanding the sources of income, links and relationships between HWIs and the entities they control, is seen as an important component in developing risk-treatment strategies relevant to the business and tax arrangements used by HWIs.²⁹

1.9 Further, maintaining a focus on HWIs' income tax compliance was expected to help the ATO develop the expertise necessary to engage with HWIs and their advisers, understand their behaviours, and deal effectively with HWI tax affairs. An ongoing focus on this category of taxpayers also sends a clear message that HWI taxpayers engaging in aggressive tax planning or non-compliance face a real risk of being pursued by the ATO, which may improve voluntary compliance. A 2009 OECD report considered Australia to

26 Only France has had a unit operating since an earlier date (1983). OECD, *Engaging with high net worth individuals in tax compliance*, 2009, p. 55.

27 ANAO, Report No. 46 1999–2000, *High Wealth Individuals Taskforce*, 2000, p. 17.

28 J Braithwaite, Y Pittelkow, R Williams, *Tax Compliance by the Very Wealthy: Red Flags of Risk*, in V Braithwaite (ed.), *Taxing Democracy*, Ashgate Publishing, 2003, p. 205.

29 J Braithwaite, *Markets in Vice, Markets in Virtue*, Oxford University Press, 2005, p. 84.

be at the forefront of compliance monitoring of the HWI taxpayer group, and concluded that Australia's dedicated unit had improved compliance and increased revenue.³⁰

1.10 In early 2011, the ATO dismantled the taskforce and integrated specialist HWI compliance work into broad active compliance teams.³¹ As of July 2013, HWI compliance was managed through the Private Groups and High Wealth Individuals (PGH) business line. The business line also manages not-for-profit organisations (190 000 entities); medium businesses (159 000 entities); and wealthy Australians (75 000 individuals).³² Compliance teams in PGH undertake the compliance work for these four population groups.

1.11 The ATO's decision to integrate the specialised HWI work into broad active compliance teams was influenced by several operational changes. The PGH business line had moved to a private wealth focus and shifted its compliance focus from businesses with a \$2–\$10 million annual turnover to turnovers of up to \$250 million. In addition, the significant growth in the HWI taxpayer population had made the taskforce client ownership model unsustainable. Also, refinements to risk engines³³ meant that the ATO was more confident that it could select cases for compliance action according to the highest identified risks instead of on generic population groups. Through compliance teams and based on the concept of collective capability³⁴, the ATO was seeking to integrate the skills and knowledge from compliance and other staff, and develop a flexible and adaptable workforce capable of undertaking the highest risk cases.

30 OECD, *Engaging with High Net Worth Individuals on Tax Compliance*, OECD Publications, 2009, pp. 62–63.

31 Integration of specialist compliance teams occurred in two phases. In July 2010, the new business model was trialled at a single office and, in January 2011, the model was rolled out nationally, with full integration across all sites achieved by October 2011.

32 Medium businesses are economic groups with a turnover of between \$2 million and \$250 million. Wealthy Australians are defined as Australian resident individuals who, together with their associates, effectively control an estimated net wealth of between \$5 million and \$30 million. ATO, *Compliance in Focus 2013–14*.

33 A risk engine is a computer program that assesses a taxpayer population against risk indicators to give each taxpayer a probability score of potential non-compliance.

34 The key elements of collective capability are: team leaders/mentors; case leadership; technical excellence; the priority technical issue escalation system; and access to the Tax Council Network for complex issues.

1.12 The ATO has also adopted an account management approach for those taxpayers that are identified as ‘key’ taxpayers.³⁵ These taxpayers are considered by the ATO to pose a significant revenue risk because of their level of wealth or ability to influence other taxpayers. By monitoring these taxpayers and their intermediaries, the ATO is seeking to ensure good compliance, and in turn, encourage others to do likewise. In 2013, the ATO had identified 211 key taxpayers across all PGH population groups, including 208 HWIs.

Administration through the PGH business line

1.13 As at 30 June 2013, the PGH business line employed 1398 staff across all functions (Table 1.2), including active compliance, interpretive assistance, engagement strategy and delivery, and technical and case leadership.

Table 1.2: PGH business line staff by function, as at 30 June 2013

Function	Number
Active compliance	821
Interpretive assistance	192
Risk intelligence and strategy	120
Technical and case leadership	120
Other functions ¹	112
Engagement strategy and delivery	33
Total	1398

Source: ATO.

Note 1: Other functions include the business line executive, policy and corporate risk, and business management functions.

1.14 In 2013–14, 310 staff³⁶ were engaged in HWI active compliance activities. These staff undertake audit and review cases³⁷ selected by the case selection team, maintain client relationships, and gather intelligence. The Engagement Strategy and Delivery team works with other relevant officers

35 This account management approach was introduced in 2012 and is referred to by the ATO as the Taxpayer and Industry Ownership Strategy.

36 Active compliance staff are located in Melbourne, Sydney, Brisbane, Adelaide, Perth and Canberra.

37 There are two main types of reviews: preliminary risk reviews, which do not generally involve contact with the taxpayer and seek to gain a better understanding of an individual's tax affairs to determine whether a more in-depth review is needed; and comprehensive risk reviews, which involve taxpayer contact and are a more detailed examination of the individual's tax affairs. Audits are specific or wide-ranging examinations of an individual's tax affairs and can involve visits to the taxpayer's premises to collect evidence. Audits are generally more intensive and take longer than a comprehensive risk review. More details on these compliance activities are presented in Table 4.1.

across the business line to design and deliver risk-based communication strategies and other educational information for the PGH market, including HWIs.

1.15 HWI taxpayer objection work is undertaken by the PGH business line's Interpretative Assistance area. The ATO's Legal Services Branch (in the ATO's Law Design and Practice Group) is responsible for managing ATO cases before courts, tribunals and enquiries. Interpretative Assistance and active compliance staff may assist the Legal Services Branch to prepare documentation for review and appeal cases.

1.16 The Technical and Case Leadership team provides technical expertise and support to active compliance staff on key tax technical issues and the more complex, significant or reputational sensitive case work. The team seeks to build technical capability across the business line by sharing knowledge through case work, mentoring, and supporting learning and development activities. It also assists with litigation and alternative dispute resolution cases. Integrating active compliance and technical staff is intended to: make it easier for compliance staff to access technical expertise; support active compliance staff in making decisions on a broader range of issues; improve tax technical decision making; and reduce compliance case cycle times.

HWI compliance resourcing and outcomes

1.17 Table 1.3 summarises the evolution of the HWI population size, funding and cash collections. It shows that from a small group of 180 individuals initially identified in 1996, the number of HWIs has grown to approximately 2600 by 2013, and potentially more as explained above (paragraph 1.5).

Table 1.3: HWI taskforce funding and key outcomes, 1996 to 2013

Year	HWIs identified (number)	Additional funding by government	Cumulative cash collections (\$ million)
1996	180	\$19.2 million over four years	0
1998	256		61
2000	491		198
2002	608		512
2004	712		1238
2006	943	\$81 million over four years	1542
2008	1342	\$89 million over four years (adjusted)	2114
2010	2644		2271
2012	2630		2807
2013	2608	\$37 million	3081

Source: ANAO analysis, based on: ATO, *Compliance Program 2012–13*, p. 55; and ATO internal documents.

1.18 Following the initial funding for HWI compliance work in 1996 (\$19.2 million), the ATO received additional funding in 2006 (\$81 million over four years) which was adjusted in 2008 (\$89 million over four years). In the 2012–13 Mid-Year Economic and Fiscal Outlook, the Government allocated ‘\$390 million funding to the ATO for further compliance activities to continue to target profit shifting and HWI and to focus on outstanding income tax lodgements in the micro and small business segments’.³⁸ The ATO advised that approximately \$37 million of this funding was to be dedicated to the implementation of a new strategy *Engaging newly identified HWIs*, which aims to confirm the status of the 3700 potential HWIs and that these newly identified HWIs meet their tax obligations.³⁹

38 The Treasury, *Mid-Year Economic and Fiscal Outlook 2012–13*, 2012, p. 46, available from <http://www.budget.gov.au/2012-13/content/myefo/download/2012-13_MYEFO.pdf> [accessed 15 May 2013].

39 ATO, *Potential HWIs: 1 July 2013 to 30 June 2017 strategy*.

1.19 One measure of success for HWI compliance activities is the amount of cash collected as a result of voluntary disclosures, reviews, audits and prosecutions. According to the ATO, since 1996, HWI compliance activities have raised almost \$3.1 billion in cash collections (Table 1.3).⁴⁰ The ATO has further committed to the Government to raise an additional \$1.3 billion in cash collections from HWI compliance activities over the four years 2013–14 to 2016–17.⁴¹ Table 1.4 summarises HWI active compliance commitments for 2013–14.

Table 1.4: HWI active compliance commitments, 2013–14

Active compliance commitment		2013–14 target
Compliance Program commitments		
Number of audit and risk reviews		500
Number of contacts to verify information or provide advice		750
Active compliance key performance indicators		
Tax liabilities		\$549 million
Cash collections		\$430 million
Commitments to government		
Newly identified HWIs		
• Number of audits and risk reviews		350
• Liabilities		\$72 million
• Cash		\$21 million
• Compliance dividend ¹		\$2 million

Source: ANAO analysis of ATO documents.

Note 1: The compliance dividend is a measure used by the ATO to assess the impact of its compliance activity across the HWI audit population commencing in 2013–14. The compliance dividend measures the change in income tax return data for individual HWI audit cases that generated outcomes for three consecutive years post audit, and compares these HWIs to their peers to determine if there has been a change in compliance behaviour. The impact is stated as future tax revenue that would have been lost without this change in behaviour.

1.20 Given the small size of the HWI population, the revenue collected through compliance activities involving HWI taxpayers is considerable. In 2012–13, the ATO collected \$7.9 billion from its compliance activities.⁴² Cash collected from compliance activities involving HWIs was \$273 million⁴³, or 3.5 per cent of this amount. At the PGH business line level for the same year,

40 ATO, *Compliance Program 2012–13*, p. 55.

41 ATO, *HWIs: 2013–18 overarching strategy*.

42 ATO, *Commissioner of Taxation Annual Report 2012–13*, p. 45.

43 *ibid.*, p. 44.

compliance activities involving HWIs generated 54 per cent of the liabilities raised, and 41 per cent of the cash collected (Table 1.5).

Table 1.5: Active compliance results by PGH population groups, 2012–13

Population groups (approximate numbers)		Liabilities raised		Cash collected	
		\$m	%	\$m	%
Not-for-profits	190 000 entities	14	1	13	2
Medium businesses	159 000 businesses	576	29	240	36
Wealthy Australians	75 000 individuals	308	16	142	21
HWI	2600 individuals	1067	54	273	41
Total		1965	100	668	100

Source: ANAO analysis of ATO documents.

1.21 The number of ATO full-time equivalent staff that work on HWI compliance activities (initially in the taskforce and, from 2011, integrated into the general compliance teams) also increased significantly, from approximately 120 in the early 2000s to 310 planned for 2013–14.

HWI compliance strategy

1.22 Being open and accountable to the Australian community is one of the ATO's values.⁴⁴ One way to demonstrate this value is through the publication, annually, of the ATO's compliance program. This program outlines the most significant risks to tax and superannuation compliance, the compliance activities allocated resources, and the types of compliance activities undertaken. In 2013–14, the ATO identified three corporate key risks, and seven HWI key risks and behaviours (Table 1.6).

44 ATO, *Compliance Program 2012–13*, p. 1.

Table 1.6: Alignment of ATO compliance risks and HWI risks and behaviours

2013–14 compliance program risks	HWI risks and behaviours
Individuals who fail to declare income or make incorrect claims for deductions and benefits.	Use of business assets for private purposes. Accessing company profits other than via dividends.
Tax risks associated with the use of complex business structures.	Significant restructures and events such as mergers, acquisitions, initial public offerings (floats), asset sales and generational change (succession planning). Lifestyles funded without relying on income in a conventional form. Concealment of overseas interests and international dealings.
Correct reporting of taxable income by wealthy individuals.	Classification of income and expenses between capital and revenue accounts. Capital gains tax not returned or inappropriately minimised.

Source: ANAO analysis of ATO documents.

1.23 These priority risks are the basis for developing a risk-management approach to compliance, and categorising HWIs according to the risks they pose to the tax system. The ATO uses data-matching, filtering and prioritising tools to assess risk, categorise the HWI population, and formulate differentiated compliance strategies. The main purposes of this risk management approach are to:

...reduce the costs of compliance for low-risk taxpayers by minimising the possible intrusiveness of [the ATO's] compliance activities; and ensure [the ATO] invests [its] resources in the areas of greatest risk.⁴⁵

⁴⁵ ATO, *Tax Compliance for Small-to-Medium Enterprises and Wealthy Individuals*, p. 15, available from <[http://www.ato.gov.au/About-ATO/About-us/In-detail/Key-documents/Tax-compliance-for-small-to-medium-enterprises-and-wealthy-individuals/?default=&page=16#Profile of the small to medium enterprises market](http://www.ato.gov.au/About-ATO/About-us/In-detail/Key-documents/Tax-compliance-for-small-to-medium-enterprises-and-wealthy-individuals/?default=&page=16#Profile%20of%20the%20small%20to%20medium%20enterprises%20market)> [accessed 11 December 2013].

Audit objective, criteria, scope and methodology

Audit objective

1.24 The objective of the audit was to assess the effectiveness of the ATO's activities to promote tax compliance by high wealth individuals.

Audit criteria and scope

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

- compliance activities were supported by effective business and administrative arrangements;
- compliance risks were identified effectively;
- compliance activities, and associated objections and reviews, were conducted effectively; and
- outcomes and objectives were achieved.

1.26 The audit covered the main activities conducted as part of the HWI compliance program, including engagement with taxpayers. However, it did not examine the ATO's efforts to address HWI non-compliance through the use of tax havens and offshore structures.⁴⁶

1.27 The ATO's compliance activities arising from the 2012–13 funding for the implementation of the *Engaging newly identified HWIs* program commenced in late 2013. For this reason, unless otherwise specified, the audit does not examine activities relating to the identification of potential HWIs under the new initiative.

Methodology

1.28 The ANAO reviewed relevant documentation, interviewed key staff at the ATO, and consulted industry stakeholder groups. The ANAO also undertook substantive testing and analysis of the ATO's databases, systems and processes as they relate to the management of HWI compliance.

⁴⁶ These activities were covered to some extent in ANAO, Audit Report No.24 2011–12, *Administration of Project Wickenby*.

1.29 The audit has been conducted in accordance with the ANAO’s auditing standards at a cost of approximately \$596 000.

Previous ANAO audits

1.30 In 1999–2000, the ANAO conducted an audit of the management and operations of the HWI taskforce⁴⁷ and concluded it was effective overall. The audit made three recommendations aimed at improving the public reporting of taskforce outcomes, and at the retention of specialist resources to deal with complex issues associated with HWI tax affairs.

1.31 In 2011–12, the ANAO conducted an audit of the ATO’s management of compliance in the Small to Medium Enterprises market⁴⁸, which included HWIs. The report made two recommendations, aimed at improving the effectiveness of the risk engine used by the then Small to Medium Enterprises business line and making more effective use of its results.

Structure of the report

1.32 Table 1.7 outlines the structure of the report.

Table 1.7: Structure of the report

Chapter and title		Overview of chapter
2	Assessing Compliance Risks	Examines the governance arrangements and the tools developed by the ATO to identify and risk-assess the HWI population. It also assesses the reliability of these tools, and how they are used to implement the HWI compliance strategy.
3	Selecting Compliance Cases	Examines the ATO’s processes for selecting the highest risk HWI cases for active compliance. It also assesses if the case selection process and the outcomes of compliance activities provide an indication of the effectiveness of the Risk Differentiation Framework.
4	Conducting Compliance Activities	Examines the ATO’s compliance activities directed towards optimising voluntary compliance by HWIs.
5	Objections and Appeals	Examines the ATO’s processing of objections and appeals against amended assessment lodged by HWIs.
6	Measuring Compliance Effectiveness	Examines the ATO’s monitoring and reporting of the performance of HWI compliance strategies and activities in mitigating compliance risks.

47 ANAO, Audit Report No. 46 1999–2000, *High Wealth Individuals Taskforce*.

48 ANAO, Audit Report No.16 2011–12, *The Management of Compliance in the Small to Medium Enterprises Market*.

2. Assessing Compliance Risks

This chapter examines the governance arrangements and the tools developed by the ATO to identify and risk-assess the HWI population. It also assesses the reliability of these tools, and how they are used to implement the HWI compliance strategy.

Introduction

2.1 Identifying the HWI population and determining differentiated levels of tax compliance risk is a key element in implementing the ATO's compliance strategy and selecting the most appropriate cases for compliance activity. This task involves four main stages:

- understanding and prioritising the risks associated with the HWI population, and determining the most appropriate compliance strategy to mitigate these risks;
- identifying HWIs and linked entities using the most effective internal and external data;
- using risk engines and analytical models to assess HWIs and determine their specific level of risk; and
- selecting appropriate cases for compliance activity, in accordance with the overall compliance strategy.

2.2 Since 2004, the ATO has been developing assessment tools to automate the identification and risk assessment of the HWI population. These tools include risk engines, data mining and analytical models with the aim of reviewing a much larger pool of taxpayers and risks in a shorter timeframe. Although the tools are designed to be more comprehensive, consistent and reliable, there remains a degree of manual intervention to support the identification of the HWI population and compliance risks. It is also important that effective governance structures and processes are in place to oversee the development and review of the risk assessment tools. Deficiencies in the operation of the risk assessment tools could lead to unnecessary costs for compliant taxpayers, a misuse of ATO's compliance resources as well as failure to address non-compliance.

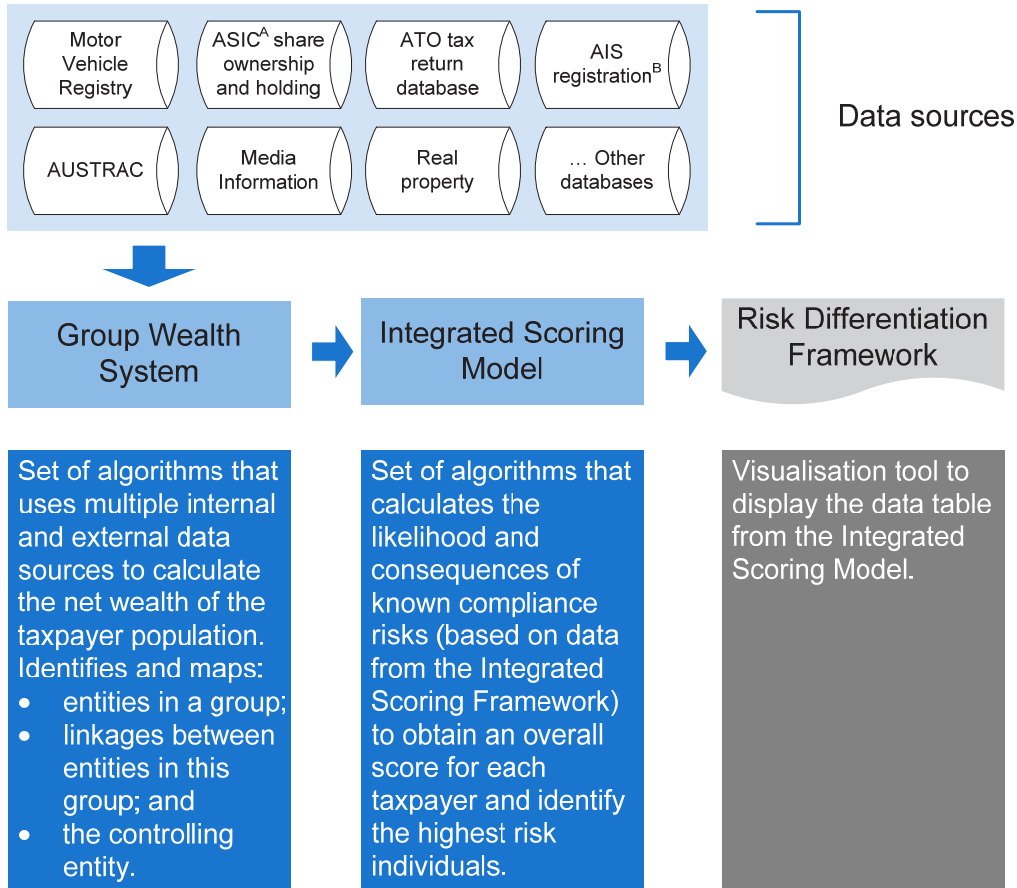
2.3 The ANAO examined the different tools used by the ATO to risk-assess the HWI population and assessed if the:

- governance structure and processes to develop and review the risks and scoring hypotheses underpinning the rating of the HWIs are effective;
- processing of data by the different assessment tools is supported by adequate controls; and that the population, risk and scoring rules implemented to identify and score the higher risk HWIs have been applied correctly; and
- setting of the boundaries between higher risk and lower risk HWIs supported the implementation of the HWI compliance strategy.

Risk assessment tools applied to the HWI population

2.4 The tools used by the PGH business line to identify and risk-assess the HWI population are continually being updated and refined, as the tax environment changes. Analysing the tools' outputs also enables the ATO to gain a better understanding of their effectiveness in identifying and assessing risks. Three main tools contribute to the risk assessment process. Figure 2.1 provides an overview of these tools and a brief description of their main functions.

Figure 2.1: HWI population identification and risk assessment tools



Source: ANAO analysis of ATO documents.

Note A: ASIC: Australian Securities and Investments Commission.

Note B: AIS refers to the database of recreational and commercial maritime vessel registrations administered by the Australian Maritime Safety Authority.

The Group Wealth System

2.5 The Group Wealth System is a set of algorithms that defines interdependencies and relationships between entities within economic groups, including individuals, trusts, partnerships and beneficiaries. It also identifies links between entities and estimates the net wealth of the controlling individual. The Group Wealth System uses a range of internal and third party data sources (such as partnership and trust beneficiary details from tax returns, Australian Securities and Investments Commission (ASIC) share ownership and ultimate holding company registers, consolidated company returns and

superannuation returns), spouse returns and indicators of wealth such as lifestyle assets, including boats, planes and thoroughbred horses.

The Integrated Scoring Model

2.6 The Integrated Scoring Model is a set of population, risk and scoring rules that are applied to the Group Wealth System data. Risk rules are a combination of characteristics and are developed to test a risk hypothesis (a proposition that explains how the ATO believes non-compliant behavior can be identified through the analysis of quantitative data). The rules are defined to: identify the HWI population; assess the HWI population against known risks; and apply a score to those risks. As at March 2014, the rules applied to 20 risk categories covering 123 risks (See Appendix 1 for a list of risk categories).

2.7 The Integrated Scoring Model also calculates a consequence and likelihood score for each HWI. Each score comprises several components that are weighted according to their perceived importance:

- as at March 2014, the consequence score components were wealth (40 per cent); total business income (40 per cent); tax at risk, based on economic performance (10 per cent); effective tax rate (five per cent); and tax reconciliation (five per cent).
- the likelihood score components were the integrated risk rules (30 per cent); economic performance (30 per cent), complexity of the HWI's entities (number and types, 10 per cent); tax performance, based on effective tax rate (15 per cent); and tax reconciliation (15 per cent).

2.8 In addition, three 'contextual attributes'⁴⁹ applied to the consequence and likelihood scores: Phoenix activity⁵⁰; start-up businesses; and advance pricing arrangements.⁵¹ These components and the weighting attributed to

49 Contextual attributes use qualitative and quantitative data-driven measures that provide further guidance about a taxpayer's compliance position. They are applied after the base calculation of the consequence or likelihood score as an uplift or downgrade factor, depending on whether the perceived risk of non-compliance is increased or decreased. For instance, tax and economic performance likelihood scores will be reduced for start-up businesses; conversely, a history of association with Phoenix activities will increase the score as these taxpayers have been found by the ATO to tend to under-report turnover.

50 Phoenix activity is defined by the ATO as the evasion of tax and/or superannuation guarantee liabilities through the deliberate, systematic and sometimes cyclic liquidation of related corporate trading entities.

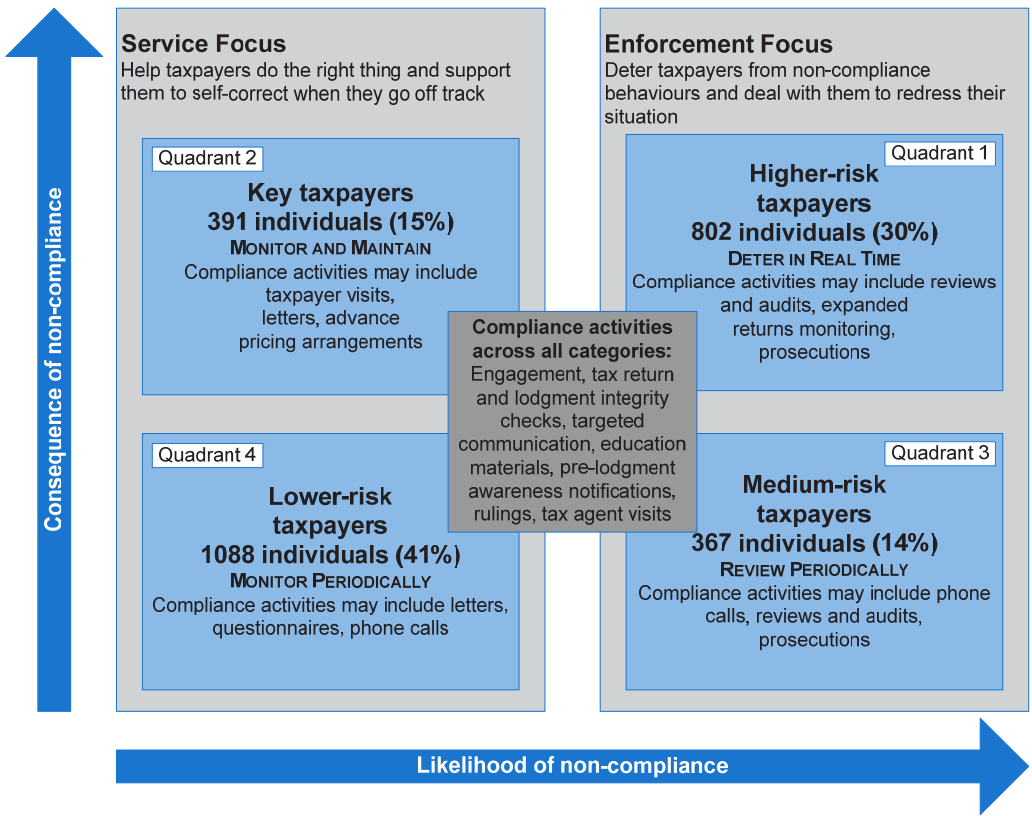
51 An advance pricing arrangement is an agreement between the ATO and the taxpayer that determines, on a prospective basis, the income tax treatment of specific international transactions over a fixed period, usually from three to five years.

them are modified over time, following identified changes in the environment and/or improved understanding of the impact of the components on compliance case selection.

The Risk Differentiation Framework

2.9 The Risk Differentiation Framework (RDF) offers a visualisation of the level of risk represented by each HWI taxpayer (Figure 2.2). All HWIs are categorised into one of four risk categories (or quadrants) representing a tax-risk profile, based on the relative likelihood of non-compliance and the consequences of any potential non-compliance. The RDF is used by the ATO to guide the nature and intensity of its interaction with taxpayers.

Figure 2.2: Risk Differentiation Framework for HWIs, 2013



Source: ANAO, based on ATO, *Tax Compliance for Small-to-Medium Enterprises and Wealthy Individuals* and ATO, Minute to the PGH Risk Management Committee, 18 October 2013.

2.10 The categorisation of each HWI's tax risk relative to other similar HWIs helps the ATO determine the nature and the level of compliance activities, and

reflects the ATO compliance model (presented in Figure 1.1). The ATO seeks to apply the following compliance responses to the four risk categories/quadrants:

- *Lower risk HWIs* are the largest category of HWIs and may be subject to basic integrity checks involving letters, questionnaires and phone calls.
- *Medium risk HWIs* are characterised by a higher likelihood of non-compliance, but a relatively low level of consequence through this non-compliance. These can expect periodic reviews from the ATO.
- *Key HWIs* are considered less likely to be non-compliant, but the consequences of any potential non-compliance are high. They are subject to consistent monitoring and the compliance activities undertaken may include taxpayer visits, letters and advance pricing arrangements.
- *Higher risk HWIs* display both a high likelihood of non-compliance and more serious consequences from non-compliance, based on the relative size of their wealth or turnover, the nature of the transactions they undertake, their effective tax rate and their compliance history. The ATO's compliance activities can include audits and reviews to deter non-compliant behaviours.

2.11 The RDF was implemented in the PGH business line in 2012. It has become an important medium for communicating the ATO's risk management approach to the HWI market.⁵² For instance, the RDF is featured in several of the ATO publications aimed at assisting HWIs to comply with tax laws, and is used by ATO executives when engaging with tax representatives.⁵³

52 While the RDF is the final visualisation of a process also involving the Group Wealth System and Integrated Scoring Model, the term RDF is used in this report to refer to the overall process.

53 ATO, *Tax Compliance for the Small-to-medium Enterprises and Wealthy Individuals*, available from <<http://www.ato.gov.au/General/Wealthy-individuals/In-detail/Compliance-information/Tax-compliance-for-small-to-medium-enterprises-and-wealthy-individuals/?page=15>> [accessed 24 February 2014], ATO, *Compliance Program 2012–13*, ATO, *Presentation to the Tax Institute (Michael Cranston)*, 2013, available from <<https://www.taxinstitute.com.au/file/bviewnow/1/itemid/B6833870-20D6-11E3-B97A005056A30183>>, [accessed 17 December 2013].

Developing and reviewing risk rules

2.12 The following three committees oversee the development of the population and risk rules underpinning the risk ratings assigned to HWIs:

- the Risk Management Committee is the principal high-level decision-making committee for the management of risk and intelligence across the PGH business line. It supports the development of a ‘comprehensive end to end compliance strategy’⁵⁴ for PGH, and meets monthly;
- the Pipeline Governance Committee was established as the ‘principal governance, decision-making and ratification forum for endorsement of proposed changes to the [PGH] risk models, risk scoring and RDF methodology’.⁵⁵ The Committee meets annually or bi-annually as the need arises. It met three times over the period 2012 and 2013; and
- the RDF Working Group has been active since June 2012 and aims ‘to develop and continually improve the [PGH] systemic risk assessment processes’⁵⁶, including the information technology systems supporting the RDF outputs. The Working Group met five times in 2012 and three times in 2013.

2.13 The ANAO reviewed the minutes of each committee since their inception. The minutes indicate that the key decisions relating to the management of the RDF process are appropriately discussed and endorsed. Following a previous ANAO recommendation⁵⁷, the ATO has recognised the importance of having strong governance mechanisms to support the development and review of risk rules.

54 ATO, *S&ME Risk Management Committee*, April 2013, available from the ATO’s intranet, accessed 12 July 2013.

55 ATO, *S&ME Pipeline Governance Committee Charter and Terms of Reference*, December 2012.

56 ATO, *S&ME RDF Working Group Charter and Terms of Reference*, December 2012.

57 ANAO, Audit Report No. 16 2011–12, *The Management of Compliance in the Small to Medium Enterprises Market*, p. 77.

2.14 The ATO has a formal process for developing new risk rules and reviewing existing rules. As part of this process:

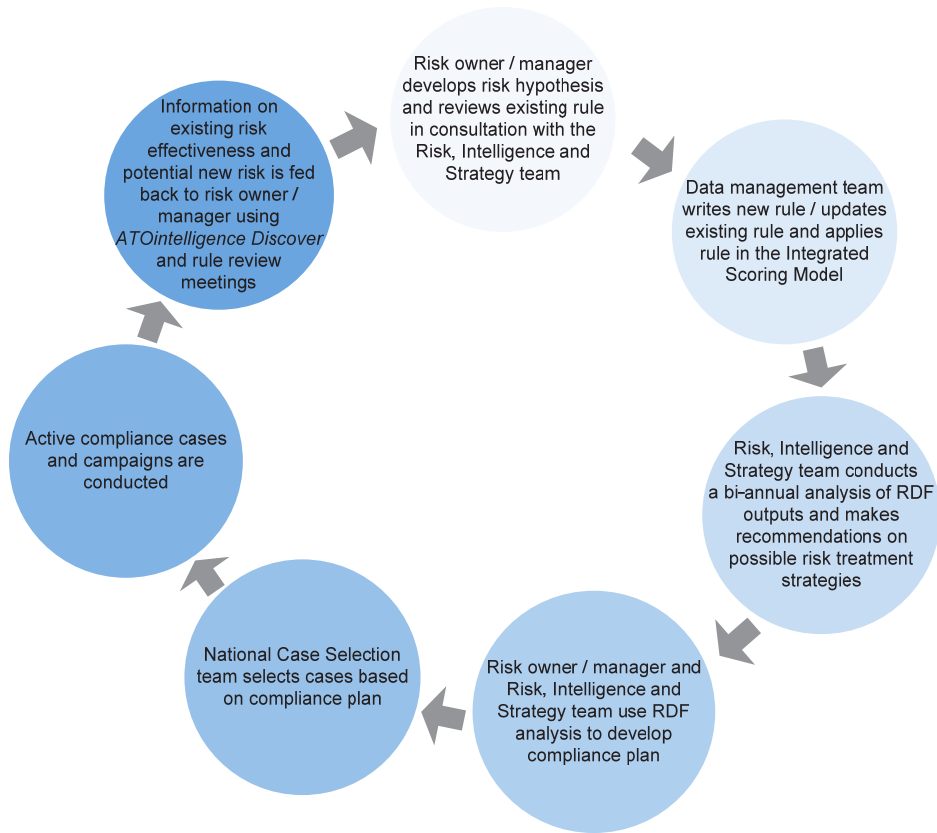
- risk managers and risk owners⁵⁸ work with the Risk, Intelligence and Strategy team to identify matters of concern using the intelligence acquired through environmental scans, projects and compliance activities. Once the risk has been documented and a rule logic developed, it must be signed-off (approved) by the risk manager and risk owner;
- the new risk rule is then developed, tested and quality-assured for integration in the Integrated Scoring Model; and
- twice a year, the Risk, Intelligence and Strategy team analyses the RDF outputs and works with the risk manager to recommend treatment strategies and a compliance plan to be implemented by the National Case Selection team and the compliance teams.

2.15 The ATO advised that existing rules are reviewed once a year for both efficiency and effectiveness, prior to the RDF being refreshed, by a team including the risk manager, a senior technical leader⁵⁹, experienced active compliance officers and a representative from the Case Selection team. The review team is expected to consider the rule logic and how the rule has been applied; the validity of the rule's supporting documents (for example, risk guide); and ways to update the rule or develop a new rule. The ATO advised that compliance officers did not attend all review workshops, because of the compliance teams' workloads.

2.16 Figure 2.3 provides a schematic representation of the risk rule development and review process.

58 The business line allocates a risk owner, at a Senior Executive Service classification, and a risk manager, at the Executive Level classification, for all priority risks. Risk owners of priority risks are responsible for: deciding the key messages; endorsing new risk rules and changes to existing risk rules; and approving compliance effectiveness measures and risk mitigation strategies. Risk managers are responsible for understanding their risk, identifying intelligence requirements and exploring whether changes are required to clarify legislation or policy. Risk managers are the key contact point for their risk within the business line.

59 Senior technical leaders are part of the Technical and Case Leadership team, a national team assisting PGH staff with the resolution of complex tax technical issues.

Figure 2.3: Risk rule development and review process

Source: ANAO analysis of ATO documents.

2.17 Sharing information between the various business capabilities involved in the identification and treatment of a compliance risk (including compliance teams), and collecting intelligence from internal and external sources, form a critical part of an effective risk management process. Compliance teams, through their work with taxpayers, are well positioned to validate existing risks and identify new ones. Their insights and case observations represent an important source of intelligence, including to identify areas of the law that may require clarification, for instance through the development of a ruling. However, collecting intelligence from active compliance teams is often a challenge as operational teams can be at risk of being disconnected from the risk rule development and review process.

2.18 The risk rule development and review process, as presented in Figure 2.3, identifies a step to provide compliance team information to the risk owners and risk managers and to the Risk, Intelligence and Strategy team. The

ANAO's discussions with a number of compliance officers indicated that they do not always feel that their feedback is valued or sought, and that even when they do provide observations on their cases, they are not advised of the outcome of their contribution.

2.19 In July 2013, the ATO released a new intelligence framework that has specifically identified compliance staff feedback as an important mechanism to detect risk, and has committed to demonstrate to compliance officers that their observations are valued. A central element of this framework is a new system, *ATOintelligence Discover*. This system is for staff, including compliance officers, to provide feedback, and to share, escalate and interrogate compliance information. The system is integrated into the electronic case management system, and replaces the previous intelligence collection system, *ATOi*.⁶⁰ It has the potential to address identified weaknesses in the feedback loop between the risk managers, risk owners, Risk Intelligence and Strategy teams and compliance teams.

2.20 Further, part of the compliance officers' tasks when conducting a case is to assess each of the identified risks (the basis on which the case was selected), to validate or refute these risks, and record in the electronic case management system the outcome of their analysis. However, there is no systematic process, using the data from compliance activities, to assess whether the compliance cases selected through the RDF process identified the higher risk cases. In his 2013 *Review into aspects of the ATO's use of compliance risk assessment tools*, the Inspector-General of Taxation reached a similar conclusion, and made a recommendation to incorporate compliance officers' experience and case work results into the risk rule review process.⁶¹ The development of such a process would enable the ATO to better assess the reliability of the RDF process to identify HWIs at higher risk of non-compliance (ANAO Recommendation 1 at paragraph 3.29 addresses this issue).

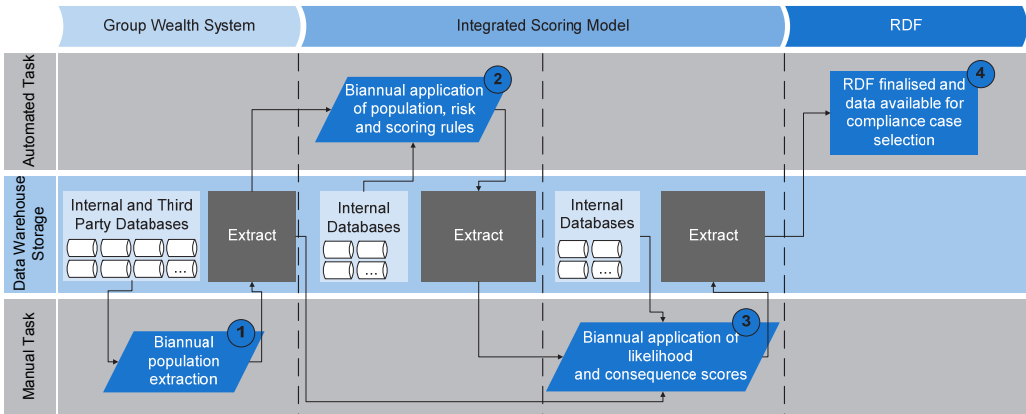
60 Other mechanisms to collect active compliance feedback include: the bi-annual rule review process, which includes participation by experienced compliance officers; and compliance officers' case discussions with compliance team leaders, who in turn communicate with risk managers.

61 Inspector-General of Taxation, *Review into aspects of the ATO's use of compliance risk assessment tools*, 2013, Recommendation 4.1, p. 111.

Data processing within the Risk Differentiation Framework

2.21 The risk assessment tools used by the PGH business line are maintained and updated by one area within the Risk, Intelligence and Strategy team: the Analytics, Information Management and Systems unit. Figure 2.4 provides a representation of the data flow leading to the development of the RDF.

Figure 2.4: Data flow for the development of the RDF



Source: ANAO analysis of ATO documents.

2.22 The data flow process involves a succession of steps, some manual and some automated, which necessitates repeated access to a range of internal and third party databases. The ATO uses an application, the Risk Assessment and Profiling Tool (RAPT), to store and execute the Integrated Scoring Model. RAPT also allows users to view the outcomes of the RDF. All the databases accessed are stored in the ATO's Enterprise Data Warehouse⁶², as are the successive outputs from the extraction process and the application of risk rules conducted at each step.

Controls supporting the data processing

2.23 The quality and integrity of data produced by IT systems is generally dependent on the complexity of the system, and on the strength of the controls in place. In the case of the RDF, the information produced is intended to be

⁶² The Data Warehouse contains replicas of the data from business systems to create business intelligence that supports business analysis and decision making.

further analysed and filtered by downstream business processes, which reduces the need for stringent controls as more reliance is being placed on the skills and experience of the technical staff who manage the process. If the RDF was a real time processing system involving financial payments, controls would need to be more robust, including specific steps to assure the quality and integrity of data.

2.24 The ANAO reviewed the IT systems supporting the RDF. These systems fall under two categories: enterprise-wide systems, and business-line specific systems. The enterprise-wide systems are the Enterprise Data Warehouse and RAPT, which are subject to the ATO's established change management processes and security access controls.

2.25 The Group Wealth System and the Integrated Scoring Model (as shown earlier in Figure 2.1) are managed by the PGH business line. As the RDF is continually being refined, controls over the data and processes are less mature, and rely on the skills and experience of the staff involved to correctly implement the data models, and to detect any errors that are present. Some documents described components of these systems, but there was no end-to-end system process documentation. Understanding of these systems is obtained primarily through discussion with the experienced IT staff who developed and support the systems. The ATO would benefit from documenting these end-to-end processes (as represented in Figure 2.4) with a focus on the key risks and judgements necessary at each stage in the risk assessment process. This documentation would provide improved control over the quality of the information produced, as well as provide guidance to staff.

Application of the population, risk and scoring rules

2.26 The ANAO selected a sample of eight HWIs scored in the RDF and assessed whether the risk rules had been correctly applied in the Integrated Scoring Model, resulting in the correct categorisation in the RDF.⁶³

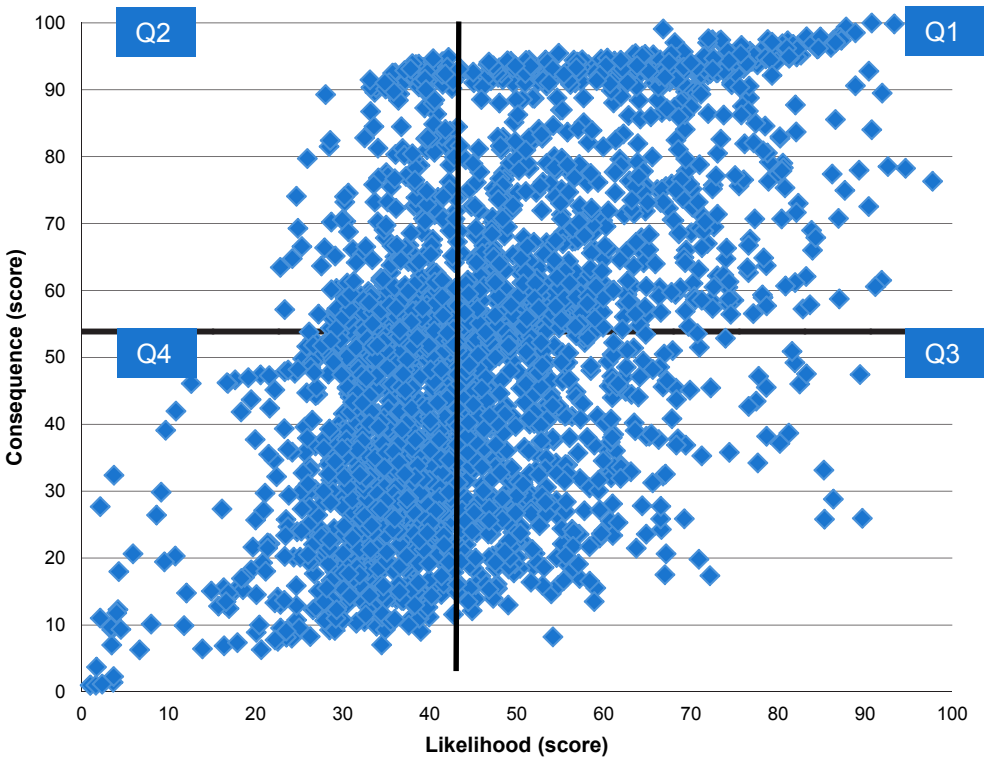
63 The sample of eight was drawn in November 2013. The sample was chosen to include two HWIs (one confirmed HWI and one candidate HWI) from each quadrant. The sample, although small, covered the whole end-to-end process of scoring the full Group Wealth System population, and tested the key system controls in respect of the RDF generation. The Group Wealth System was excluded from the testing because it relies on data from external sources that is known to be incomplete. Data matching results in further elimination of data in the Group Wealth System. Testing the system controls, in these circumstances, would not add value.

2.27 The systems had correctly applied the rules in each case, and the RDF correctly reported the output from those rules. Also, for all cases, the classification of a case in a specific RDF quadrant matched the values recorded, confirming that the execution of the RDF was correct.

Determining Risk Differentiation Framework quadrants

2.28 As previously discussed, the RDF process is used by the ATO to determine the level of risk each HWI represents by assessing the relative likelihood of HWIs not meeting their tax obligations and the consequences of potential non-compliance. The distribution of the HWI population on the consequence/likelihood RDF visualisation is presented in Figure 2.5. The quadrant boundaries were positioned by the Applied Risk, Information, Intelligence and Strategy team, in October 2013, at 53.86 on the consequence axis and 46.24 on the likelihood axis (out of a maximum score of 100).

Figure 2.5: HWI population distribution on the RDF, September 2013



Source: ANAO analysis of ATO data.

2.29 The ATO determined the position of these boundaries relative to its active compliance resources and commitments, and moves the boundaries to accommodate the different commitments and strategies relative to each quadrant. For example, the consequence axis boundary was lowered in October 2013 because the pool of HWIs suitable for review in Quadrant 1 was exhausted, and 150 additional cases were needed to meet the compliance plan commitments.

2.30 While it is important that the levels of active compliance resources and commitment inform the development of the compliance strategy, a sound risk management approach would see the boundaries between higher risk and lower risk individuals determined by an analysis of the risk in absolute terms and of the ATO's tolerance for the risk. Such an approach would also better reflect the publicly reported compliance strategy, in particular that 'placing a taxpayer in a higher risk category means we apply more comprehensive verification activities according to the risk they pose and the consequences should there be non-compliance.'⁶⁴ The implication was that there is first an overall assessment of compliance risk for each HWI and then an application of compliance treatments appropriate to that risk. According to the methodology adopted, however, the converse applied—it was the distribution of the number of various compliance treatments to be applied that year that dictated the boundaries of the RDF model and accordingly the allocation of HWIs to risk categories.

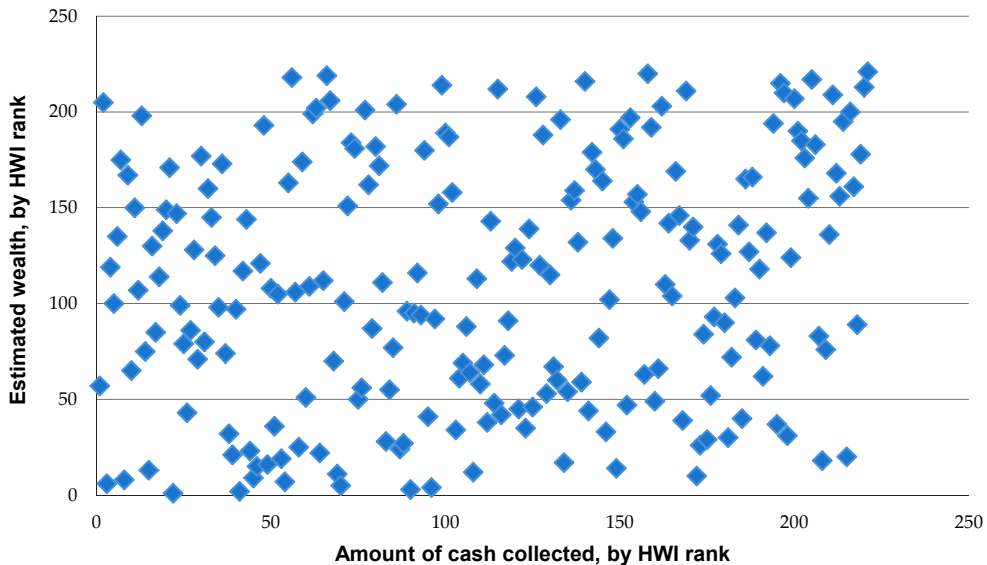
2.31 Further, the weight attributed to wealth and business income⁶⁵ meant that the wealthiest HWIs could not be categorised as low or medium risk, no matter how unlikely they were to be non-compliant. Conversely, HWIs who had a high likelihood of being non-compliant, but had a 'moderate' wealth and income when compared to the other HWIs, could not be categorised as higher risk HWIs. While it may be that the potential non-compliance of the wealthiest HWIs could have the greatest consequences in terms of tax revenue loss, the RDF scoring algorithms, as they were weighted, presented a risk of over-estimating the impact of wealth and income on potential non-compliance.

64 ATO, *Tax compliance for small-to-medium enterprises and wealthy individuals*, p. 16.

65 These two components of the Integrated Scoring Model algorithms contribute to 80 per cent of the total consequence score, as outlined in paragraph 2.7.

2.32 The ANAO examined the link between wealth and non-compliance, using the outcomes from the compliance activities completed between 2009–10 and 2012–13. One test was the correlation between the amount of cash collected following a compliance activity and the HWIs estimated wealth. As shown in Figure 2.6, there was no distinct pattern for these cash collections and estimated wealth, indicating little or no correlation between the two.

Figure 2.6: Correlation between wealth and cash collected following compliance activities, 2009–10 to 2012–13



Source: ANAO analysis of ATO data.

Note: The scattergram is based on: the 221 HWIs and potential HWIs who were subject to one or more audits and/or reviews between 2009–10 and 2012–13 and who had some cash collected by the ATO as a result of these compliance activities.

2.33 The ANAO also assessed the correlation between a HWI's wealth and non-compliance, by examining the outcomes of the audits and reviews of HWIs and potential HWIs conducted between 2009–10 and 2012–13 according to estimated wealth. This analysis also found little or no correlation between the two.

2.34 In order to confirm the validity of the weight attributed to the other risk factors (including business income) used in the Integrated Scoring Model, there would be benefit in the ATO conducting similar analysis to test the link between these factors (including business income), and the consequence and likelihood of non-compliance.

2.35 The ATO advised in March 2014 that it was refining the RDF process based on a fixed-boundary model. The single boundary (on the likelihood axis) would set the PGH business line's tolerance of risk and create two pools of taxpayers (those presenting tolerable risk and intolerable risk). Additional population groups administered by the PGH business line, including wealthy Australians, would be mapped on the new RDF. Consequently, the axes will be recalibrated and the weightings of each component used to determine the likelihood and consequence axes will be reviewed. The ANAO has not reviewed this new version of the RDF process.

Conclusion

2.36 Since 2004, the ATO has been using and improving a suite of tools to identify and risk-assess the HWI population. The RDF process was introduced in 2012, and since then has been regularly refined to improve its accuracy. The ATO has developed effective governance mechanisms to oversee the development and review of the risk assessment tools. There are however some weaknesses in the collection and analysis of feedback from compliance teams, which may be addressed by the new intelligence system, *ATOintelligence Discover*. There is also no systematic process for reconciling the risks identified through the RDF processes with the risks validated or otherwise by the compliance teams.

2.37 The PGH business line's risk assessment tools have evolved in an iterative manner and are still work-in-progress, with new concepts being tested and ongoing improvements being implemented. Consequently, while the RDF control environment is not as mature as some other ATO systems, it is suitable for the context in which it operates, that is identifying and risk rating the HWI population from which compliance cases can be selected (further discussed in Chapter 3). The ATO could take steps, however, to improve the documentation of the end-to-end RDF tools and processes.

2.38 The RDF provides a visualisation of the likelihood of taxpayer non-compliance and the consequence of that non-compliance. Until March 2014, the ATO determined the position of the quadrant boundaries between higher and lower risk HWIs on the basis of its compliance resources and commitments rather than in relation to an analysis of risk tolerance. The weighting applied to wealth and income of HWI taxpayers was a significant determinant of their risk levels. However, as demonstrated by the ANAO's analysis of recent active compliance activities, there was little correlation

between a HWT's estimated wealth and non-compliance, and between wealth and the amount of cash collected by the ATO following a successful compliance activity.

2.39 The ATO advised in March 2014 that as part of the development of a new version of the RDF, the positioning of the quadrants will be determined based on an analysis of risk tolerance rather than compliance resources. Also, the weighting attributed to different risk factors in the RDF will be reviewed to cater for the complexity and risk profiles associated with the recent recalibration of the PGH population (inclusion of private groups with turnover greater than \$250 million).

3. Selecting Compliance Cases

This chapter examines the ATO's processes for selecting the highest risk HWI cases for active compliance. It also assesses if the case selection process and the outcomes of compliance activities provide an indication of the effectiveness of the Risk Differentiation Framework.

Introduction

3.1 The case selection process is a key step in the implementation of the ATO's compliance strategy. Selecting the right cases underpins the success of meeting the compliance goals outlined in the strategy. The case selection process is designed to identify the highest risk HWI cases so that they can be more closely examined by the active compliance teams.

3.2 The ANAO examined the HWI's compliance case selection process to assess if the:

- cases selected were those representing the highest risk and, if not, there was a coherent strategy for the selection of lower risk cases; and
- case selection process and outcomes of active compliance activities provided an indication of the effectiveness of the RDF process to identify the highest risk compliance cases.

The ANAO analysed data relating to the HWI cases selected for active compliance activities from December 2010 to September 2013.⁶⁶

National Case Selection process

3.3 Since January 2011, the case selection process in the PGH business line has been coordinated by a single team, the National Case Selection team (previously known as 'front end operations').⁶⁷ Figure 3.1 provides a representation of the selection process, which involves the following steps:

- the National Case Selection team consults with the Population Strategy team and risk managers to identify, based on the business line

⁶⁶ The National Case Selection team has been recording the RDF quadrant for selected cases since October 2011. The database also included 522 potential HWIs, who have been included in the analysis.

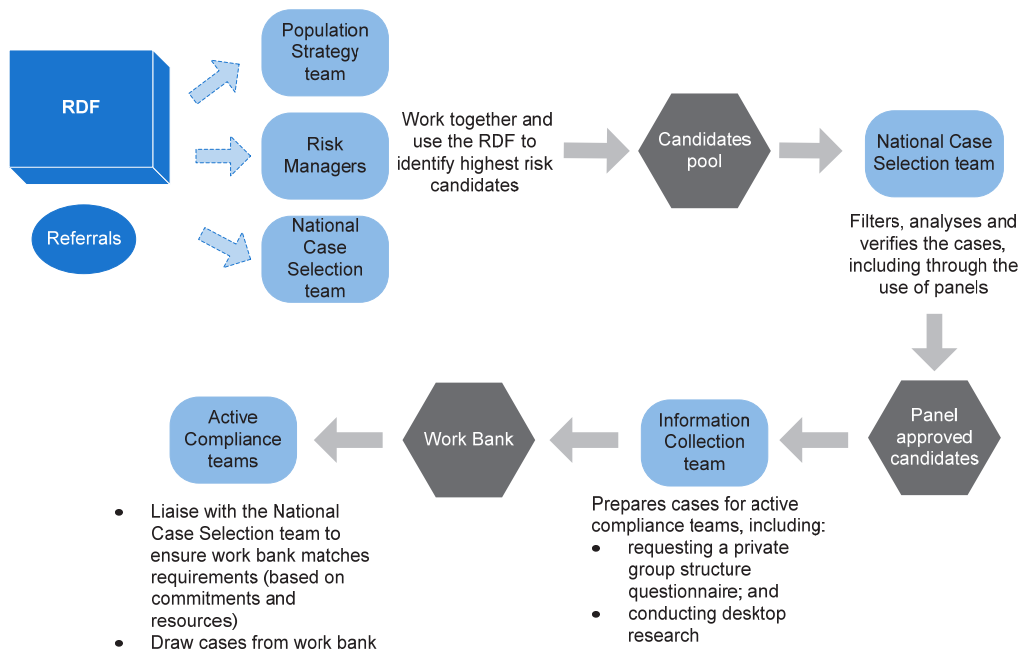
⁶⁷ The ATO advised that while the National Selection Team commenced operation in January 2011, there was a period of transition, to November 2011, during which other PGH staff (in particular, compliance teams) were able to select cases without the National Case Selection team's involvement.

compliance strategy, the highest risk taxpayers. Candidates are primarily identified through the RDF process and the application of risk rules. A secondary and minor source of candidates comes from internal and external referrals received via *ATOi* (now replaced by *ATOintelligence Discover*).

- the candidate pool is then manually filtered and analysed by the National Case Selection team to remove anomalies. This filtering process has been instrumental in refining the RDF risk rules (for instance, following feedback from the National Case Selection team, a rule was created to exclude cases that had been audited or reviewed in the previous 18 months).
- panels, comprising a minimum of four directors working across a range of capabilities and including HWI auditors, are then convened to determine if the candidate warrants referral to active compliance (to be submitted for either a preliminary risk review or a comprehensive risk review), or if it should be rejected ('NFA'—no further action).
- candidates approved by the panels are then referred by the National Case Selection team to the Information Collection team to prepare the case for active compliance teams. The role of the Information Collection team is to conduct desktop research, including data matching and if considered necessary by the panels, to request from the candidate a private group structure questionnaire.⁶⁸
- once information collection is complete (and where a private group structure questionnaire is required, this step can take up to 60 days), the candidates are placed in a 'work bank', and available for distribution to the active compliance teams.

68 The private group structure questionnaire requests the full details of all private entities associated with the HWI, the HWI's family members or other associates. It helps the ATO gather information to gain a better understanding of how HWIs conduct their business and tax affairs. Taxpayers have 28 days to return the completed questionnaire. Available from <http://www.ato.gov.au/Calculators-and-tools/Highly-Wealthy-individuals-entity-questionnaire/> [accessed 24 January 2014].

Figure 3.1: Case selection process



Source: ANAO analysis of ATO documents.

3.4 The aim of the case selection process is to provide a ‘just in time’ pool of risk cases, reflecting the PGH compliance strategy. The selection of cases available also needs to match the requirements of the Active Compliance teams, based on the teams’ commitments and resources. These requirements are described in the PGH delivery plan, and based on the commitments outlined in the annual business line plan. The delivery plan identifies, for all case compliance teams around the country and by region, the number and type of cases that are needed to meet the annual commitments. The delivery plan is updated regularly to reflect the progress of compliance activities.

3.5 The ANAO examined the HWI data recorded by the National Case Selection team on cases assessed between December 2010 and September 2013. Twenty-seven panels were convened during this period, considering a total of 1445 HWI cases, of which 94 per cent were identified using the RDF process (other sources were referrals and ‘spin-off’ cases⁶⁹) (Table 3.1).

⁶⁹ ‘Spin-off’ cases are those that have been escalated from a less intensive compliance activity, such as a preliminary risk review, to a more intensive activity, such as a comprehensive risk review or an audit. These cases do not go through the National Case Selection process. A new case number is created directly by the active compliance teams.

Table 3.1: Cases assessed by the National Case Selection team, December 2010 to September 2013

Cases assessed per financial year	Cases sourced from RDF		
	No.	No.	%
December 2010–June 11	155	155	100
2011–12	589	553	94
2012–13	531	496	93
July–Sept 2013	170	159	94
Total	1445	1363	94

Source: ANAO analysis of ATO data.

3.6 Three outcomes are possible for candidates considered in the selection process:

- rated as no further action, if the panel assesses that the risks presented by the candidate are not sufficiently high;
- referred to active compliance for a preliminary risk review, when the panel agrees that the risks identified through the RDF process are valid, and warrant further desktop examination; or
- referred to active compliance for a comprehensive risk review, when the panel agrees that the risks are valid and significant, and warrant contacting the taxpayer to request further information.

3.7 The results of the panels' assessments (outlined in Table 3.2) indicate that results were consistent for the period December 2010 to July 2013, with the majority of cases (52 to 55 per cent) referred to active compliance for a preliminary risk review. The balance of remaining cases (42 to 48 per cent) were rated as no further action, and between one to three per cent of cases were referred for a comprehensive risk review.

Table 3.2: Panel decisions, December 2010 to September 2013

Cases assessed per financial year	Panel decision						
	No further action cases			Cases selected for a preliminary risk review		Cases selected for a comprehensive risk review	
	No.	No.	%	No.	%	No.	%
December 2010–June 2011	155	74	48	80	52	1	1
2011–12	589	247	42	326	55	16	3
2012–13	505	230	46	263	52	12	2
July–Sept 2013	163	69	42	24	15	70	43
Total	1412	620	44	693	49	99	7

Source: ANAO analysis of ATO data.

Note: A database of 1445 cases was provided by the ATO. The panel decision was not recorded for 33 of these cases (2 per cent) assessed from July 2012. The table is based on the reduced sample pool of 1412 cases. Percentages may not add to 100 due to rounding.

3.8 From July 2013, to further streamline the process, and taking into account improvements to the RDF process through feedback, the ATO has removed the use of panels to select HWI candidates for active compliance action. The ATO's revised policy was that all HWIs from the highest risk quadrant of the RDF (Quadrant 1) and the top 10 per cent of HWIs of other population groups may be subject to a comprehensive risk review. These cases were, however, submitted to a brief examination by the National Case Selection team (comprised of ex-compliance officers), that considers if the risks identified by the RDF appear to be valid and warrant further investigation.

3.9 The revised policy is reflected in the case numbers outlined in Table 3.2 from July to September 2013. Over this period, while the number of cases considered to require no further action remained consistent with the previous years at 42 per cent, the number of cases referred for a comprehensive risk review rose to 43 per cent (between one and three per cent in previous years).

3.10 The ATO advised in March 2014 that subsequent to the implementation of the revised version of the RDF, the RDF will not identify the four current broad risk categories (quadrants). Rather the RDF will be a two-category model: lower risk/concern and higher risk/concern. However cases to be selected for a 'heavier touch' (reviews and audits) will still be drawn, overall, from the pool of higher-risk candidates, as identified through the RDF process.

3.11 The ANAO identified in its audit of the management of compliance in the small to medium enterprises market in 2011, that the absence of a centralised case selection process presented some limitations, and that at the time, the business line had no assurance that it was targeting the highest priority cases.⁷⁰ The establishment of the subsequent National Case Selection team has addressed some of the issues raised by the ANAO. In particular, the National Case Selection process supports:

- the national oversight of case selection;
- a more systematic and robust process for selecting cases (through panels and/or analysis by the National Case Selection team); and
- better alignment between the compliance strategy and active compliance resources and commitments.

Selecting the highest risk cases

3.12 The ANAO examined the National Case Selection database to determine whether, for the period October 2011 to September 2013⁷¹, the cases selected using the RDF process were those presenting the highest compliance risks. Table 3.3 indicates that while 60 per cent of cases originated from Quadrant 1 (the highest risk quadrant), a substantial proportion (24 per cent) were also drawn from the lowest risk quadrant (Quadrant 4). Another nine and seven per cent of cases were selected from Quadrant 3 and Quadrant 2 respectively.

70 ANAO, Audit Report No. 16 2011–12, *The Management of Compliance in the Small to Medium Enterprises Market*, p. 91. As previously noted, the Small to Medium Enterprises business line became the Private Groups and High Wealth Individuals business line in July 2013.

71 The RDF quadrant source was only recorded from October 2011.

Table 3.3: RDF quadrant of selected compliance cases, October 2011 to September 2013

RDF quadrant	2011–12		2012–13		2013 to September		Total	
	No.	%	No.	%	No.	%	No.	%
Quadrant 1	39	9	451	90	161	99	651	60
Quadrant 2	74	17	5	1	0	0	79	7
Quadrant 3	53	12	46	9	2	1	101	9
Quadrant 4	259	61	0	0	0	0	259	24
Total	425	100	502	100	163	100	1090	100

Source: ANAO analysis of ATO data.

Note: A database of 1445 cases was provided by the ATO. The RDF quadrant was identified, from October 2011, in 1090 of these cases (75 per cent). The table is based on that reduced sample pool. Percentages may not add to 100 due to rounding.

3.13 The ATO advised that once the pool of Quadrant 1 candidates was exhausted (that is, all candidates had been assessed), a decision was made by the Population Strategy team, in consultation with the business line executives to draw on cases from the other quadrants. The additional cases selected presented likelihood and consequence profiles that were similar to that of cases from Quadrant 1.⁷²

3.14 Reviewing compliance outcomes from cases drawn from different risk quadrants can assist in determining the validity of the RDF categorisation. Using a sample of the cases drawn from the four quadrants in 2011–12 would have enabled the ATO to analyse the outcomes of cases across all quadrants to assess the effectiveness of the RDF process. However such analysis was not undertaken.

Using the case selection process to measure the effectiveness of the RDF

3.15 The Inspector-General of Taxation recommended in his 2011 report that the ATO should ‘assess the effectiveness of its upstream risk identification processes’.⁷³ In response, in February 2013 the PGH business line conducted

⁷² The ATO advised that a high number of cases was selected from Quadrant 4 as that quadrant had a higher proportion of cases than Quadrants 2 and 3.

⁷³ Inspector-General of Taxation, *Review into the ATO’s compliance approaches to small to medium enterprises with annual turnovers between \$100 million and \$250 million and high wealth individuals*, December 2011, p. 72.

the first review of its risk assessment processes since the introduction of the RDF process in 2012. The review identified five key measures that supported the assessment of the performance of the risk assessment tools. Table 3.4 lists these measures and the ANAO's assessment of their suitability.

Table 3.4: Performance measures of risk assessment tools

Performance measure	Description	ANAO assessment of the suitability of the measure
Strike rate	Only calculated for cases for which an audit was conducted. A 'strike' case is recorded where a financial outcome was reached. The strike rate is: total 'strike' audit cases divided by total audit cases.	A higher strike rate may indicate that the initial risk assessment was correct. This is a partial measure of risk assessment performance as it only includes audits. It also implies that a risk was correctly identified if a financial outcome was reached — whereas a financial outcome may have been reached based on a different risk identified by the compliance officer. The strike rate is not adjusted for the results of objections or appeals.
Escalation rate	Escalation from a lower intensity compliance activity, for instance a preliminary risk review, to a higher intensity activity, for instance a comprehensive risk review.	An escalation can indicate that the initial selection of the case was worthwhile as a compliance risk was confirmed. However, cases may have been escalated following the identification of a new risk during the course of the review, rather than confirmation of the risk originally identified. Also, the risk may have been resolved by the lower level compliance activity (such as preliminary risk review prompting a voluntary disclosure). In this circumstance the case would not be escalated, but would result in a positive outcome.
No further action case analysis	A case can be assessed as no further action by the active compliance teams for a range of reasons, including that the risk for which the case was selected in the first place was not confirmed. Cases that have been assessed as no further action are closed.	A high rate of cases assessed as no further action can indicate that the initial risk assessment was incorrect. This measure requires significant manual analysis (each case must be individually accessed and analysed in the case management system). It also relies on the accurate recording of information by the compliance officer.

Performance measure	Description	ANAO assessment of the suitability of the measure
National Case Selection panel validation rate	The proportion of cases that have been selected through the RDF process and subsequently validated by the National Case Selection panels (composed of experienced active compliance officers, who independently review the cases) as worthy of further action by the active compliance area.	Improvement in the validation rate indicates an increase in the panel's confidence in cases selected through the RDF process. It provides a good indication of the effectiveness of the RDF process in identifying cases that can be further investigated by the compliance teams. However, it does not measure the effectiveness of the RDF process in identifying valid risks, as these are only validated through subsequent compliance activities. The ATO no longer uses panels.
Risk rule confirmation rate	Compares the risks identified through the RDF process to the risks confirmed, not addressed or newly identified by the compliance officer, using information recorded by the compliance team in the electronic case management system.	This is the only direct and the most reliable measure of the performance of the risk tools as it focuses on the risk, which is the key determinant for the identification of cases in the RDF. It requires considerable manual analysis and relies on the accurate and comprehensive recording of case notes by the compliance officer.

Source: ANAO analysis of ATO documents.

3.16 Of the five measures, three (strike rate, escalation rate and panel validation rate) were being assessed and reported to the PGH executive management prior to the February 2013 review. The two other measures, no further action case analysis and risk rule confirmation rate, were compiled for the purpose of the February 2013 review. The PGH report proposed that the results be used as a baseline for subsequent assessment of these two measures.

3.17 The February 2013 review focused on the compliance cases initiated and completed between July and October 2012 (112 cases). The sample did not include any audits as this activity has a longer cycle time than the four-month period selected for the review. Consequently, the strike rate, which is calculated only on audits, was not assessed. The escalation rate was reported to be 29 per cent, consistent with other periods.⁷⁴

⁷⁴ The ANAO examined the escalation rate for the panels conducted from July to October 2012 (four panels) and found an escalation rate of 45 per cent. This result could not be reconciled with the result presented in the ATO report (29 per cent).

3.18 The results reported by the ATO for the three other measures were as follows:

- the panel validation rate was found to be 79 per cent, which meant that around eight out of 10 cases identified by the RDF process were confirmed as worthy of further investigation by the National Case Selection panels. This result was compared to the panel validation rate for cases submitted in 2011, before the introduction of the RDF, and was found to be six percentage points higher in 2012.⁷⁵
- the results from the no further action case analysis and risk rule confirmation rate were combined. The report concluded that 62 risk rules were identified across the 112 cases reviewed, 13 of which required refinement. These 13 rules were to be reconsidered in subsequent RDF updates.

3.19 Of the five performance measures, the risk rule confirmation rate contributes most strongly to the assessment of the effectiveness of the risk assessment tools. According to the ATO, the results from the February 2013 report provided very useful information on the effectiveness of the rules, and on ways to improve them. The ATO has not repeated the analysis but advised that other processes were used to assess the effectiveness of the risk rules, in particular the risk rule review described in paragraphs 2.14 and 2.15 and the new intelligence gathering tool *ATOintelligence Discover*. However, the review of the risk rule process, even when feedback from compliance teams is included, does not replace the quantitative assessment of the outcomes of the active compliance cases. Such assessment is a key element to evaluating the effectiveness of the RDF process.

⁷⁵ The ANAO analysed panels conducted July to October 2012 and found a validation rate of 65 per cent. This result could not be reconciled with the result presented in the ATO report (79 per cent).

ANAO analysis of compliance cases identified through the RDF

3.20 The ANAO analysed the compliance cases identified through the RDF process and assessed by the National Case Selection process in 2011–12 and 2012–13 (to September 2013) in order to gain insight into the effectiveness of case selection. Data from the selection process and from the active compliance work can be used to assess the effectiveness of the RDF process in several ways:

- *Cases rated as no further action by the National Case Selection process:* The RDF process provides for the rules to be improved continuously through feedback from the selection process and from compliance outcomes. This should result in the proportion of cases rated as no further action decreasing over time. In addition, the large number of cases selected in 2011–12 from the lowest risk quadrant, Quadrant 4, enables a comparison with cases from Quadrant 1. For example, if the RDF process is effective in categorising the highest risk candidates in Quadrant 1, the number of cases rated as no further action should be substantially lower in this quadrant than in the lowest risk quadrant, Quadrant 4.
- *National Case Selection decision to direct cases to a preliminary risk review or a comprehensive risk review (validation rate):* the cases for which the RDF-identified risks have been confirmed by the National Case Selection team and are directed to active compliance. Consequently, the number of cases directed toward a preliminary or a comprehensive risk review should be higher in Quadrant 1 than in Quadrant 4.
- *Active compliance escalation rate:* As indicated in Table 3.4, escalation of a case to a more intense compliance activity can indicate that the initial risk identification by the RDF was correct. Further, the escalation rate could be expected to be higher from cases from Quadrant 1 than from Quadrant 4.
- *Active compliance case outcome:* an outcome from a compliance case is achieved when a liability is raised. Cases originating from the higher risk quadrants should reach an outcome more often than other cases. However, it is not currently possible to conduct this analysis as the RDF quadrant is not recorded consistently in the ATO's electronic case management system.

3.21 The number of cases rated as no further action has remained relatively stable over time, at 44 per cent on average for the period December 2010 to September 2013 (Table 3.2 on page 66). Table 3.5 shows that the percentage of no further action cases, and the percentage of cases directed to active compliance for a preliminary risk review, are comparable across all quadrants.

Table 3.5: National Case Selection decisions, October 2011 to September 2013

RDF quadrant	No further action cases			Cases selected for a preliminary risk review		Cases selected for a comprehensive risk review	
	No.	No.	%	No.	%	No.	%
Quadrant 1	651	296	45	277	43	78	12
Quadrant 2	79	37	47	41	52	1	1
Quadrant 3	101	49	49	45	45	7	7
Quadrant 4	259	108	42	143	55	8	3
Total	1090	490	45	506	46	94	9

Source: ANAO analysis of ATO data.

3.22 Table 3.6 presents the results of the escalation rate analysis, overall and by quadrant, for the 424 compliance cases completed in 2011–12 and 2012–13.

Table 3.6: Active compliance escalation rate by RDF quadrant, 2011–12 and 2012–13

Compliance cases	Financial year			Quadrant			
	2011–12	2012–13	Total	Quadrant 1	Quadrant 2	Quadrant 3	Quadrant 4
Total cases completed	251	173	424	165	51	47	161
No. of cases escalated	110	68	178	71	20	14	73
% of cases escalated	44	39	42	43	39	30	45

Source: ANAO analysis of ATO data.

3.23 The results from Table 3.5 and Table 3.6 indicate that:

- the RDF process has not improved its effectiveness in identifying the highest risk cases over this time period. Consistently since 2011–12, about one in two cases selected through the RDF process are deemed to warrant further examination by the National Case Selection process;
- there are no significant variations in the National Case Selection team’s decisions for cases from different quadrants. Whether a case is categorised as higher or lower risk through the RDF process does not demonstrably impact on the decision reached by the National Case Selection, following manual examination of the case; and
- the escalation rate is not significantly different over time, or between cases from different quadrants. Whether a case is categorised as higher or lower risk by the RDF process does not impact on the decision by active compliance teams to escalate (or not) the case for a more intensive examination.

3.24 As previously mentioned, there are limitations in the completeness of this analysis.⁷⁶ However, these results create uncertainties regarding the effectiveness of the RDF process in differentiating the risk profile of HWI taxpayers.

Conclusion

3.25 The establishment of the National Case Selection process in January 2011 has contributed to a more coordinated approach to selecting compliance cases. The ATO uses the RDF as the primary source of cases selected for active compliance, with 94 per cent of cases selected between December 2010 and September 2013 having been identified through the RDF process. In 2011–12 the ATO selected 61 per cent of compliance cases from the lower risk quadrant of the RDF (Quadrant 4), but with likelihood and consequences profiles considered similar to higher risk cases. In the subsequent period to September 2013, almost all cases were selected from the highest risk quadrant (Quadrant 1).

⁷⁶ In particular, the ATO advised that although sourced from different quadrants, the cases from Quadrant 4 presented likelihood and consequence profiles similar to those of Quadrant 1.

3.26 In response to a recommendation from the Inspector-General of Taxation, the ATO initiated a review of its risk assessment processes. Five measures were developed. Useful information was collected from one of these measures, the risk rule confirmation rate, which was used to improve the RDF process. The ATO has not repeated the exercise. Evaluating the effectiveness of the RDF process in identifying the highest risk compliance cases assists in assessing if compliance resources are being used effectively, and supports continuous improvement processes. There would be benefit in the ATO collecting and analysing the relevant performance data.

3.27 The pool of lower risk cases selected for compliance action in 2011–12 allowed the ANAO to assess the validity of the RDF ratings by comparing the outcomes of the National Case Selection and active compliance processes between these cases and high risk rated cases. This analysis showed no improvement in the performance of the RDF over time; and no significant difference in compliance outcomes between higher risk cases (Quadrant 1) and lower risk cases (Quadrant 4). This analysis raises issues about the effectiveness of the RDF process in selecting the highest risk cases and emphasises the importance of the ATO regularly reviewing the RDF process as initially planned.

3.28 The ATO advised in March 2014 that the four risk categories reflected by the quadrants will not be used in the new version of the RDF. However, this change in the categorisation of higher and lower risk HWIs does not preclude the need for the evaluation of the compliance outcomes, in order to test the effectiveness of the RDF.

Recommendation No.1

3.29 To improve the reliability of the Risk Differentiation Framework (RDF), the ANAO recommends that the ATO analyses the outcomes of active compliance cases to assess the effectiveness of the RDF process in identifying those HWI taxpayers at higher risk of non-compliance.

ATO response:

3.30 *Agreed. The ATO will continue to build upon our existing approaches to improve our risk assessment process.*

4. Conducting Compliance Activities

This chapter examines the ATO's compliance activities directed towards optimising voluntary compliance by HWI taxpayers.

Introduction

4.1 One of the ATO's goals is to support people to understand their rights and responsibilities, and protect the community by deterring, detecting and dealing with those taxpayers who do not meet their obligations.⁷⁷ To achieve this goal, the ATO uses two broad categories of compliance activities: voluntary compliance activities that encourage taxpayers and their representatives to understand and comply with their obligations; and active compliance activities that seek to verify information or enforce tax law.

4.2 Voluntary compliance is promoted through marketing and communication strategies, and interpretative assistance such as general advice, rulings and interpretation of legislation. Active compliance includes targeted campaigns, reviews and audits. Campaigns are aimed at delivering compliance education, gathering intelligence and conducting early intervention activities. In the PGH business line, campaigns typically target specific risks (such as under-reporting of capital gains tax or fraudulent Phoenix behaviour), identified across the entire PGH population, rather than for specific populations. Only a minority of campaigns will target HWIs as a specific group. Rather, HWIs will be included in campaigns, together with other PGH taxpayers, when they represent a targeted risk. Campaigns are conducted through letters, telephone calls, or other communication media such as webinars. Risk assessment tools, in particular the Integrated Scoring Model, are used to identify those taxpayers who will be subject to a risk-based campaign.

4.3 The ATO conducts three types of reviews and audits, according to the level of perceived risk: preliminary risk reviews⁷⁸; comprehensive risk reviews; and audits. Table 4.1 outlines their purpose and cycle time standards.

77 ATO, *Compliance Program 2012–13*, p. 1.

78 The ATO advised that the PGH business line has not conducted preliminary risk reviews since June 2013.

Table 4.1: Characteristics of ATO key active compliance activities

Activity	Purpose	Cycle time standards ¹
Preliminary risk review	Develop an understanding of a taxpayer's business structure and activities, tax obligations and risk profile to determine if further review is warranted. Internal review that may not involve contact with taxpayer.	Between 40 and 60 days
Comprehensive risk review	Detailed analysis of a taxpayer's private and business activities to determine if identified risks require further explanation or treatment. Taxpayers are provided with an opportunity to respond to identified risks.	Between 30 and 365 days
Audit	Specific issue or wide-ranging investigation to confirm that the correct tax has been paid. They usually follow a risk review although cases may go straight to audit from case selection. Audits may be desktop, where the ATO contacts the taxpayer by letter or telephone, or a field audit, where the ATO collects evidence from the taxpayer's premises.	Between 180 and 1095 days (three years)

Source: ANAO analysis of ATO documents.

Note 1: Cycle times refer to the timeframe for completion of a review or audit 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. During the course of the audit, cycle times were changed: comprehensive risk reviews should not exceed 180 days and audits should not exceed 720 days.

4.4 The ATO allocates significant resources to active compliance activities, which also impose a compliance burden and cost on taxpayers. Audits, in particular, usually involve substantial interaction between the ATO and the taxpayer, with the taxpayer incurring costs in: complying with ATO requests for information and meetings; seeking professional advice on technical tax issues; and engaging technical expertise to assist in responding to audit requests for information.

4.5 The ANAO examined the effectiveness of key elements of the ATO's compliance program for HWI taxpayers, focusing on the period 2009–10 to 2012–13, by reviewing the:

- activities to encourage and improve voluntary compliance; and
- conduct of audits and reviews.

4.6 The ANAO's review focused on the ATO's administrative processes, including key approval and control mechanisms. The ANAO did not assess the accuracy of decisions involving the application of tax law or other relevant considerations.

Voluntary compliance activities

4.7 The ATO seeks to improve voluntary compliance by: informing HWIs—to raise awareness and influence participation in the system; and consulting, involving, and collaborating—to foster an environment that encourages willing participation. In order to achieve this, the ATO has committed to:

- provide taxpayers with the tools and support to help them meet their obligations; and
- engage directly with HWIs and work closely with their tax agents to help HWIs meet their tax obligations.

Providing tools and support

4.8 The ATO website has a dedicated ‘wealthy individuals’ page for HWIs, potential HWIs, wealthy Australians and their advisers. The webpage contains hyperlinks to the PGH’s key publication, *Tax compliance for small to medium enterprises and wealthy individuals*⁷⁹, and targeted forms and information, such as the private group structure questionnaire. The PGH publication sets out the ATO’s approach to risk management, and contains hyperlinks to ATO website pages and publications. It targets the entire PGH market, including HWIs, and was developed with assistance and feedback from a number of key stakeholders.⁸⁰ Between September 2012 and 31 December 2013, the publication was accessed online almost 12 000 times.

4.9 Users can also access tax specific information, such as online tools and calculators. Technical assistance is available from the wealthy individuals webpage or via: one of the portals for registered users; or the individuals, business, non-profit, super, and tax professionals tabs. Users can search the website using the tax topics tab.

79 Released in September 2012, the booklet replaced the ATO’s *Wealthy and Wise: A Tax Guide for Australia’s Wealthiest People* booklet. The new booklet sets out the ATO’s approach to compliance approaches for private groups, HWIs and wealthy Australians. Available from <<http://www.ato.gov.au/General/Wealthy-individuals/In-detail/Compliance-information/Tax-compliance-for-small-to-medium-enterprises-and-wealthy-individuals/?default=&page=1>> [accessed 19 November 2013].

80 The ATO established an external reference group drawn from a broad cross-section of law and accounting firms and consulted key stakeholders, including the National Tax Liaison Group forum members, members of the Small and Medium Enterprises community, and ATO staff.

4.10 In addition, the ATO's online media centre provides links to: speeches by the Commissioner of Taxation and senior ATO executives; ATO media releases; and various articles on tax topics. Senior ATO executives are regularly interviewed and reported in the printed media, and use these opportunities to publicise the ATO's key messages.⁸¹

Direct engagement

4.11 The ATO has had an ongoing focus on HWIs and their advisers since 1996 and has built and modified its engagement and communication strategies over many years. The ATO writes to newly identified HWIs to remind them of their tax obligations. As over 95 per cent of PGH taxpayers are represented by a tax practitioner, the ATO also visits the largest accounting firms and has a schedule of visits to selected tax practitioners to discuss RDF risk reports. Stakeholders consulted by the ANAO acknowledged that the ATO senior executive team has made significant effort to establish positive working relationships with HWIs, through their representatives, for many years.⁸²

4.12 The ATO also engages with taxpayers, industry groups and tax practitioners through ATO and PGH business line forums. Of relevance to HWIs and their representatives are the ATO Tax Practitioner Advisory Group and the National Tax Liaison Group. Under new consultation arrangements, issues may also be registered with the ATO for attention by the relevant business area.

4.13 To reduce compliance costs and to provide greater certainty, the ATO and taxpayers may also enter into an annual compliance agreement such as an advance pricing arrangement. These arrangements determine, in advance, the income tax treatment of specified international transactions over a fixed period, usually between three and five years. The ATO advised that despite efforts to promote this type of arrangements to HWIs, only one agreement had been signed during the period 2009–10 to 2012–13. HWIs can also request a public or private binding ruling for areas of the law where the ATO has not yet

81 For example, Katie Walsh, 'Taxman doubles its special scrutiny', *Australian Financial Review*, 16 July 2013, and Nassim Khadem, 'Tax Office in pursuit of wealth', *Business Review Weekly*, May 23–July 3 2013.

82 The ANAO invited 24 accounting and law firms and industry representatives to provide feedback on the ATO's management of compliance of HWI taxpayers. Of these, 14 participated in teleconferences conducted in October 2013.

established a clear position or if the taxpayers desire certainty on the ATO's view about a specific transaction.⁸³

4.14 The ATO has a number of strategies in place to assess and evaluate the effectiveness of its voluntary compliance activities at the PGH market level. It monitors media coverage and conducts regular surveys and market research of taxpayers and tax practitioners. In relation to HWIs, however, no market research or evaluation of voluntary compliance activities has been conducted since 2009–10. The ATO's Business Perceptions Survey included some questions relating specifically to wealthy Australians for the first time in 2013.⁸⁴

Conclusion

4.15 The ATO's strategy to improve voluntary compliance by HWI taxpayers includes being transparent about its key areas of focus, providing information and engaging with HWIs and their representatives. Key messages are disseminated through the ATO's compliance program, annual reports, speeches delivered by the Commissioner and senior ATO executives, and the media.

4.16 There are few activities that specifically target HWIs, with almost all voluntary compliance activities directed towards the broader PGH market. As most PGH taxpayers, including HWIs, engage tax practitioners, the ATO has, however, developed a range of activities that engage directly with tax practitioners.

Active compliance campaigns

4.17 The PGH business line conducts compliance campaigns to target risks, using the risk assessment tools supporting the RDF, across all the PGH taxpayer populations. In almost all cases, the HWI population is not targeted specifically. In 2013–14, the PGH business line committed to conduct 425 campaign activities, only seven of which will specifically target HWI taxpayers (on tax risks associated with: non-lodgement; capital gains tax; and tax treatment of gains and losses from financial arrangements). HWIs may also

83 The ATO does not keep a separate record of rulings requested by HWIs.

84 The questions concerned awareness of the ATO's 'wealthy Australians programs' (13 per cent of respondents were aware); and perceptions of how effectively the ATO deals with the tax obligations of the wealthy in Australia. The ATO advised that opinions were split on this second question, with 40 per cent of small and medium enterprises considering that the ATO dealt with the tax obligation of the wealthy in Australia effectively, but a similar proportion (38 per cent) disagreed.

be included in campaigns focusing on other risks, where these risks apply more generically.

4.18 While the ATO identifies the planned campaigns that may include HWIs, it does not report specifically on the extent to which HWIs have actually been covered by these campaigns. The only compliance activities reported for HWIs are audits and reviews. Identifying the extent to which HWIs are included in PGH risk-focused campaigns would enable the ATO to report its performance in conducting compliance activities in line with the compliance strategy.

Audits and reviews

4.19 Using data recorded on the ATO's case management system, the ANAO reviewed the ATO's conduct of HWI audits and reviews finalised between 2009–10 and 2012–13⁸⁵ against the following criteria:

- outcomes, in particular financial outcomes and population coverage;
- timeliness, including the ATO's performance against service standards;
- costs, examining how the ATO assesses the cost of audits and reviews;
- documentation, focusing on the accurate recording of key documents and approvals; and
- engagement with stakeholders.

Outcomes

4.20 Since 2009–10, the ATO has completed on average 775 HWI audits and reviews every year. For 2013–14, the PGH case plan proposes 119 audits and 835 risk reviews of HWI taxpayers. Over the 2009–10 to 2012–13 period, the ATO completed 3100 HWI audits and reviews (Table 4.2).

85 The database comprised 330 potential HWIs, which for reporting purposes are referred to as HWIs.

Table 4.2: Completed HWI audits and reviews, 2009–10 to 2012–13

Activity	2009–10	2010–11	2011–12	2012–13	Total
Preliminary risk review	518	396	459	439	1812
Comprehensive risk review	328	240	196	236	1000
Audit	27	74	95	92	288
Total	873	710	750	767	3100

Source: ANAO analysis of ATO data.

4.21 For each compliance case, the ATO records the amount of liability raised, if any, and the amount of cash eventually collected. For the period 2009–10 to 2012–13, 378 cases raised a liability, for a total value of \$3.2 billion. The top 10 cases raised 40 per cent of all liabilities, and 95 per cent of all liabilities were raised from the top third⁸⁶ of cases (Table 4.3).

Table 4.3: Liabilities raised from HWI compliance activities, 2009–10 to 2012–13

Tier	Liabilities raised	Per cent
Top third (126 cases)	\$3 001 370 629	95
Middle third (126 cases)	\$153 746 799	5
Bottom third (126 cases)	\$10 937 178	0
Total (378 cases)	\$3 166 054 606	100

Source: ANAO analysis of ATO data.

4.22 The ATO advised that cash collections can be delayed due to long payment schedules and dispute resolution activities. Also, liabilities may be collected in subsequent years for the 2009–13 period, and adjustments to losses can have a positive effect on future revenue collections. The ANAO's analysis determined that 159 HWI reviews and 136 audits conducted during the period 2009–10 to 2012–13 recorded a cash collection.⁸⁷ The total amount of cash collected for these compliance activities was almost \$852 million, 27 per cent of all liabilities raised by the ATO. Ninety per cent of all the cash was collected

⁸⁶ This comprised the 126 cases that generated the highest amount of liabilities raised.

⁸⁷ Cases that have not yet been recorded as completed on the ATO electronic case management system can still indicate an amount of cash collected. These cases have been included in the ANAO analysis. In total, there were 446 audits and 1192 comprehensive risk reviews in progress or completed for the period 2009–10 to 2012–13.

from the top third of cases. The bottom third generated less than one per cent of the cash collected (Table 4.4).

Table 4.4: Cash collected from HWI compliance activities, 2009–10 to 2012–13

Tier	Cash collected	Per cent
Top third (98 cases)	\$769 887 977	90
Middle third (98 cases)	\$74 240 073	9
Bottom third (99 cases)	\$7 741 313	1
Total (295 cases)	\$851 869 363	100

Source: ANAO analysis of ATO data.

4.23 The ANAO assessed the proportion of audits and comprehensive risk reviews with a financial outcome. Preliminary risk reviews were excluded from the analysis as they do not generally reach a financial outcome or involve contact with the taxpayer.⁸⁸ Rather, if the compliance officers consider the risks worth pursuing, they escalate the case to a more intensive activity, usually a comprehensive risk review, which can have three outcomes: issue of an amended assessment; escalation to audit; and decision to take no further action. A comprehensive review that is escalated to an audit is not considered by the ATO to represent a negative outcome, as the ensuing audit may reach a financial outcome. Further, the ATO advised that, while financial outcomes are not generally expected from comprehensive risk reviews, they occur where straightforward adjustments are required, including when taxpayers take the opportunity to make voluntary disclosures.

4.24 The ANAO's analysis of the proportion of HWI cases with a financial outcome estimated that 16 per cent of comprehensive risk reviews and 30 per cent of audits completed or still in progress during the period 2009–10 to 2012–13 resulted in a cash collection.⁸⁹ Forty-nine per cent of all cash collected from audits was from the top 10 audits, and 52 per cent of all cash

88 Between 2009–10 and 2012–13, only five (out of 1812 completed) preliminary risk reviews had a financial outcome, totaling \$3.6 million.

89 This analysis was an estimate as the ATO's records did not indicate whether a case had been escalated prior to 2011–12. For the two-year period 2011–12 and 2012–13, 102 comprehensive risk reviews were escalated to audits. Extrapolating this number to the four years 2009–10 to 2012–13, 204 reviews (of 1192) can be considered to have been escalated to audits that could reach a financial outcome. The ANAO removed these 204 potentially successful compliance activities from the base number of comprehensive risk reviews completed or in progress (1192 minus 204) and used the total (988) to calculate the rate of financial outcome (154 divided by 988 is 16 per cent).

collected from comprehensive risk reviews was from the top 10 reviews. Ninety per cent of all the cash was collected from 12 per cent of audits and five per cent of comprehensive risk reviews completed or still in progress (Table 4.5).

Table 4.5: Cash collected from HWI audits and comprehensive risk reviews, 2009–10 to 2012–13

Audits	
Total number of audits with a cash collection	136
Total cash collected from audits	\$671 million
Cash collected from the top 10 audits	49%
Number (%) of audits to collect 90 per cent of the cash collected from audits	55 (12%)
Comprehensive risk reviews	
Total number of comprehensive risk reviews with a cash collection	154
Total cash collected from comprehensive risk reviews	\$177 million
Cash collected from the top 10 comprehensive risk reviews	52%
Number (%) of comprehensive risk reviews to collect 90 per cent of the cash collected from these reviews	49 (5%)
Total cash collected from audits and comprehensive risk reviews	\$848 million

Source: ANAO analysis of ATO data.

4.25 The ANAO examined the extent of audit and review coverage among the HWI population for the period, and identified that 2421 HWIs had been subject to at least one audit or review. Given that the size of HWI population has been relatively stable over the last four years (approximately 2600), approximately nine out of 10 HWIs had either a preliminary risk review, comprehensive risk review or an audit of their tax affairs over the period. Removing preliminary risk reviews, 53 per cent (1381) of all HWIs have had at least one comprehensive risk review or audit conducted on their tax affairs.

4.26 The size of the HWI population is limited. While the population size will increase following confirmation of a number of potential HWIs, achieving the number of annual audits and reviews planned (see paragraph 4.20) will mean that virtually the entire HWI population will be subject to a review or an audit over a four-year cycle irrespective of their compliance risk category. Therefore, the ATO will be unlikely to select active compliance cases only from higher risk cases as specified in the published HWI compliance strategy. Planned changes to the RDF announced by the ATO in March 2014, together

with the increase of the HWI population, have the potential to address this issue.

Timeliness

4.27 Cycle time standards are determined at the beginning of a case and vary according to the type of activity and complexity of the issues. While there are general standards for different activities⁹⁰, the compliance team may decide to allocate a shorter or longer cycle time after initial analysis of the case's level of complexity. This information is recorded in the electronic case management system for each compliance case, and enabled the ANAO to determine that:

- 79 per cent of preliminary risk reviews had an allocated cycle time of 60 days;
- 57 per cent of comprehensive risk reviews had an allocated cycle time of 240 days, and 33 per cent of 180 days (six months); and
- 69 per cent of audits had an allocated cycle time of 730 days (24 months).

4.28 The ANAO examined the number of reviews and audits that were completed within and outside the allocated cycle time (Table 4.6).

Table 4.6: HWI reviews and audits completed within and outside cycle times, 2009–10 to 2012–13

Activity	Completed within cycle time		Completed outside cycle time		Total
	No.	%	No.	%	No.
Preliminary risk review	1253	69	559	31	1812
Comprehensive risk review	489	49	511	51	1000
Audit	160	56	128	44	288
Total	1902	61	1198	39	3100

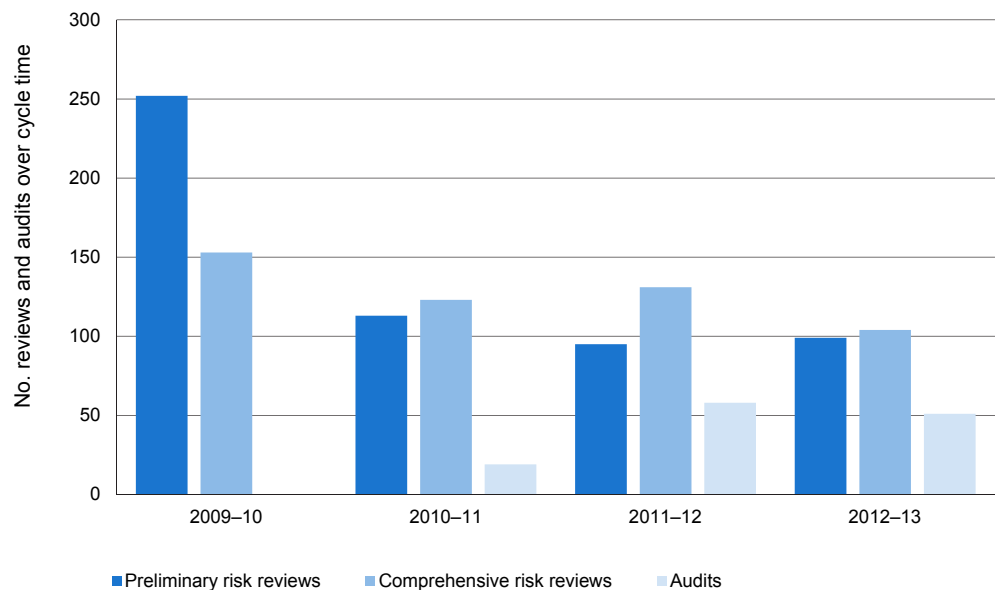
Source: ANAO analysis of ATO data.

⁹⁰ For the period examined by the ANAO, preliminary risk reviews should have taken between 40 and 60 days; comprehensive risk reviews between 30 and 365 days, and audits between 180 and 1095 days. The current cycle times are: 60 days for preliminary risk reviews; 180 days for comprehensive risk reviews; and 730 days for audits.

4.29 Between 2009–10 and 2012–13, almost 40 per cent of reviews and audits were not completed within the allocated cycle times. The average time to complete: an audit was 716 days; a comprehensive risk review was 250 days; and a preliminary risk review was 67 days. Audits that did not meet the cycle time standard exceeded it by an average of 352 days; comprehensive risk reviews by an average of 152 days; and preliminary risk reviews by an average of 65 days.

4.30 The number of preliminary risk reviews that exceeded the cycle time decreased significantly from 2009–10 to 2010–11 (Figure 4.1). The number of over-time comprehensive risk reviews remained relatively stable from 2009–10 to 2012–13, while the number of over-time audits increased from 19 in 2010–11 to around 50 for the two following years.

Figure 4.1: HWI reviews and audits completed outside cycle times, 2009–10 to 2012–13



Source: ANAO analysis of ATO data.

4.31 Exceeding cycle times, especially for activities with long completion times such as audits, imposes a burden on the taxpayer and generally increases the cost of conducting the compliance activity for the ATO.

4.32 The ATO has an ongoing focus on reducing the number of aged cases. At the time of the audit, PGH's aged case target for all active compliance cases was 20 cases by 30 June 2014. To improve performance against cycle time standards and to reduce the number of aged cases, PGH has streamlined active case management processes. From the second half of 2013, through a process referred to as the National Case Appraisal Team reengineering, an increased focus was placed on: better planning with more direction around audit planning for active compliance officers; the development of more robust draft audit plans, targeted to the taxpayer being audited; the return on investment (or materiality); and earlier engagement of the Technical and Case Leadership expertise, particularly for complex audits. Cycle time standards may also be reduced for less complex reviews and audits.

4.33 While the need to await an internal tax position or lack of active case management may impact on performance against cycle time standards, feedback from ANAO interviews with active compliance staff indicated that achieving cycle time standards is largely influenced by a HWI's willingness to co-operate with the ATO. More than half of the 31 active compliance officers interviewed by the ANAO nominated managing timeframes and the increased focus on cycle time standards as their greatest challenge.

4.34 Conversely, almost half of stakeholders consulted by the ANAO indicated that they had experienced significant delays during the course of an audit or review and that HWIs were keen to avoid delays because of the significant cost to them and the problems that can arise from making business decisions while under investigation by the ATO. Some taxpayers claimed that, after responding to ATO information requests, the ATO did not contact them for lengthy periods or until it had concluded the audit or review. HWIs and their representatives described these delays as frustrating and stressful.

4.35 There would be benefit in the ATO continuing its effort to improve the active management of cases and to implement measures aimed at further developing the capability of compliance officers to actively manage compliance cases. While doing this, the ATO could also investigate the reasons for the large number of compliance cases that achieve a financial outcome arising from cases exceeding their cycle times (Table 4.7).

Table 4.7: Completed HWI audits and comprehensive risk reviews with a financial outcome by cycle time, 2009–10 to 2012–13¹

Activity	Cases	Cases with a financial outcome		Total value of financial outcome (cash collected)	
	No.	No.	%	\$ million	%
Audits					
Completed within cycle time	160	49	31	\$162	29
Completed outside cycle time	128	65	51	\$395	71
Total	288	114	40	\$557	100
Comprehensive risk reviews					
Completed within cycle time	489	44	9	\$38	26
Completed outside cycle time	511	90	18	\$110	74
Total	1000	134	13	\$149	100

Source: ANAO analysis of ATO data.

Note 1: This table includes only completed audits and comprehensive risk reviews, which differs from Table 4.5 that also include audits and reviews in progress.

4.36 Approximately 40 per cent of audits completed between 2009–10 and 2012–13 had a financial outcome (cash collection). However, audits that did not achieve the cycle time standard were more likely to have a financial outcome than those that adhered to the standard—51 per cent compared to 31 per cent. The financial outcomes from audits that did not achieve the cycle time standard accounted for 71 per cent of cash collected.

4.37 Similar to audits, comprehensive risk reviews that did not achieve the cycle time standard were more likely to have a financial outcome than those that met the standard—18 per cent compared to nine per cent. The financial outcomes from comprehensive risk reviews that did not achieve the cycle time standard accounted for 74 per cent of cash collected.

Cost of audits and reviews

4.38 Return on investment is the main indicator used by the PGH business line to calculate the cost of audits. It is calculated by dividing the total amount of liability raised (but not necessarily collected) through HWI compliance work by the average salary cost of compliance staff conducting this work. Table 4.8 indicates that, based on liabilities raised, the return on active compliance investment from 2009–10 to 2012–13 was high and had improved markedly, from \$10.36 to \$27.26.

Table 4.8: Return on investment for HWI compliance activities, 2009–10 to 2012–13

Year	Number of full time equivalent compliance staff	Average salary \$	Liability \$ million	Cash collected \$ million	Return on investment (based on liability) \$	Return on investment (based on cash collected) \$
2009–10	353	99 364	364	42 ¹	10.36	1.20
2010–11	360	104 093	839	199	22.39	5.30
2011–12	363	108 242	888	337	22.61	8.58
2012–13	349	112 504	1070	274	27.26	6.97

Source: ANAO analysis of ATO data.

Note 1: For 2009–10, the ATO reported a cash collection of \$51 million (and a return on investment based on cash collected of \$1.46), which was \$9 million more than in the data provided to the ANAO. The ATO advised that the difference was due to eight cases that were closed in 2008–09 but resulted in cash collected in 2009–10.

4.39 A more reliable methodology to calculate the return on investment would be to use the amount of cash collected, in addition to liability raised. As demonstrated in paragraph 4.22, the difference between liability raised and cash actually collected is considerable. Based on this method of calculation, the return of HWI compliance activities is reduced significantly, from \$27.26 for every dollar spent on salary in 2012–13 to \$6.97, and has been reasonably stable since 2010–11.⁹¹

4.40 The ATO advised that, since the integration of the HWI taskforce in 2010–11, no separate cost centre for HWI staff has existed. The electronic case management system records time elapsed on activities, but not the amount of staff time actually spent on activities. Consequently, the ATO cannot identify or analyse the cost of HWI compliance activities, and the number of staff working on HWI compliance activities can only be estimated. For instance, the PGH plan for 2013–14 estimated that the equivalent of 310 full time staff would be engaged on HWI compliance activities.

4.41 HWIs are a key population group within the PGH business line—while only consisting of approximately 2650 individuals in 2012–13, some 41 per cent of the cash collected following compliance activities by the business line came from this population (see paragraph 1.20). As reflected in Table 4.5, 90 per cent

91 A proportion of the liability raised may be collected in the future, increasing the value of cash collected and the return on investment.

of the cash collected between 2009–10 and 2012–13 came from 12 per cent of audits and five per cent of comprehensive risk reviews undertaken. These results suggest that efficiencies could be obtained by better targeting compliance activities conducted on HWI and other PGH taxpayers.

4.42 In the context of reduced resourcing across the ATO, it is important to determine where compliance effort should be best directed. Compliance activities may take a long time to complete, and be costly, both for the ATO and taxpayers. Understanding the cost of conducting HWI compliance activities would underpin any cost-benefit analysis of these activities.

Recommendation No.2

4.43 To enable the ATO to more efficiently allocate compliance resources across the Private Groups and High Wealth Individuals business line, and to more accurately demonstrate return on investment, the ANAO recommends that the ATO:

- (a) better assesses the cost of compliance activities for the HWI population; and
- (b) calculates the return on investment for HWI compliance activities on the basis of cash collected, in addition to liabilities raised.

ATO response:

4.44 *Agreed.*

Compliance documentation

4.45 The ATO's audit and review procedures require active compliance officers to record key documents in the electronic case management system to enable: monitoring and quality control of audit and comprehensive risk review cases; access to key information in any objection or legal process; and quality assurance reviews. The key documents that underpin planning and decision making in audit and comprehensive risk review cases are the case plan and the final case report (or position paper for audits). Table 4.9 details the purpose of these two documents.

Table 4.9: Key documents for planning and recording decisions of HWI audits and comprehensive risk reviews

Document	Purpose
Case plan	<p>Internal planning document that sets out milestones in line with case cycle time, stakeholder engagement strategies, and internal risk mitigation strategies.</p> <p>For audits, the case plan is also known as the management plan. Its purpose is to provide taxpayers with a clear understanding of the audit, the tax risks being audited, the audit process and the proposed audit project plan timelines. The ATO and HWI taxpayers agree to the plan at the outset of the audit.</p>
Final case report or Position paper (audits only)	<p>Key internal document that set out the scope and outcomes of the audit or review, in particular: the reasons for any recommendations; the risks and risk rating; and any further action required.</p> <p>For audits, the final case report may be replaced with a position paper. The position paper provides the taxpayer with an opportunity to respond to the ATO's position (the ATO's analysis of the available facts, its application of tax law to those facts, and details of any proposed amendments or recommendations), before an audit is finalised. The ATO takes into account the taxpayer's response to a draft position paper in making a final decision.</p>

Source: ANAO analysis of ATO documents.

4.46 ATO guidelines require approvals and sign-offs to be recorded by an appropriate delegate at defined control points, including: at the completion of planning; for key findings and decisions; and on completion of the case. Approving officers are required to record their approval against each procedural sign-off on the case management system.

4.47 The ANAO reviewed 244 audits and comprehensive risk reviews finalised between 2009–10 and 2012–13 (25 audits and 219 reviews), examining the accurate recording of key documents and of key approvals.⁹² Table 4.10 presents the results of the ANAO's testing, with almost all cases (95 per cent) having the required case plan attached in the case management system. The majority of cases also recorded either a final case report or a position paper (82 per cent).

⁹² Many HWI comprehensive risk reviews and audits are complex and contain thousands of pages of evidence. For these cases, the ATO only attaches key documents to the electronic case management system, but aims to retain all evidence on paper-based files. The ANAO only reviewed documentation attached to the electronic case management system.

Table 4.10: Finalised HWI audits and reviews with recorded key documents in the case management system

Activity	Completed cases with key documents recorded in the electronic case management system	
	No. (%)	
	Case plan	Final case report or position paper (audits only)
Comprehensive risk review (219)	209 (95%)	180 (82%)
Audit (25)	23 (92%)	21 (84%)
Total (244)	232 (95%)	201 (82%)

Source: ANAO analysis of ATO data.

4.48 In terms of recording approvals, most sampled audits and reviews recorded case plan, risk decision, and case outcomes approvals (Table 4.11). Performance against the recommendation activity approval was lower: 76 per cent of the audits and 59 per cent of the comprehensive risk reviews recorded a recommendation approval.

Table 4.11: Finalised HWI audits and reviews with recorded approvals in the case management system

Activity	Completed cases with approvals recorded in the electronic case management system			
	No. (%)			
	Case plan approval	Recommendations approval	Risk decisions approval	Case outcomes approval
Comprehensive risk review (219)	205 (94%)	130 (59%)	217 (99%)	217 (99%)
Audit (25)	21 (84%)	19 (76%)	22 (88%)	24 (96%)
Total (244)	226 (93%)	149 (61%)	239 (98%)	241 (99%)

Source: ANAO analysis of ATO data.

4.49 All control points require an approval, with one exception.⁹³ It is important, for accountability purposes and to support the subsequent work of objection officers, that all key case documentation and activity approvals are recorded in the case management system. This is particularly the case for HWIs, as around two thirds of the cases are subject to objection (discussed further in Chapter 5).

⁹³ A recommendation approval is not required for early exit cases (cases for which the compliance officer makes an early determination that the case is not worth pursuing).

Quality assurance reviews

4.50 The Integrated Quality Framework (IQF) is the quality assurance process used by the ATO to improve and assure the quality of a range of activities, including audits and risk reviews. The ANAO examined the IQF results for the period 2010–11 to 2012–13 for HWI audits and reviews. A total of 75 HWI cases were assessed during this period, which represented 16 per cent of all active compliance cases assessed through the IQF, and five per cent of HWI reviews and audits finalised during the period.

4.51 Overall, the IQF results indicated that the HWI cases performed highly against the criteria measuring integrity, correctness, appropriateness and effectiveness (over 90 per cent of the cases rated a pass). These results refer to the quality of the work and decisions made by the compliance teams.

4.52 Transparency was the criterion found to be lacking most often (either requiring improvement or failing in 43 per cent of cases). This rating reflected weaknesses found in the recording of activities in the case management system. In most cases these shortfalls did not affect the quality of the decision, as they referred to a lack of adherence to administrative processes (for instance, naming conventions used inconsistently). In some cases however, key documents supporting the decision making process were missing from the case management system file, which affected the capacity of the IQF assessor to determine the quality of the decision. Other criteria identified as requiring improvement included timeliness (25 per cent of all cases), consistency (17 per cent), administrative soundness (16 per cent) and efficiency (12 per cent).

4.53 The IQF process also requires the conduct of Community Involvement Workshops. These workshops involve the engagement of a suitably qualified community representative (such as a tax agent, lawyer or academic) who reviews quality management processes, case procedures and decisions, as part of a review panel.

4.54 The ANAO reviewed the reports provided by the community representatives for the three workshops conducted between January 2012 and June 2013.⁹⁴ While generally commending the overall quality of the work and decisions made by the compliance teams, the community representatives also

94 Between eight and 20 cases were reviewed during each of the workshops. The cases covered a range of audits and reviews and included a limited number of HWI cases.

consistently commented on the difficulty encountered in assessing some of the cases due to insufficient or incomplete documentation on the electronic case management system. This result is consistent with the findings from the IQF. In this regard, feedback from interviews with active compliance officers during the audit indicated that the case management system is rigid, slow and duplicates work. Staff reported that they routinely encountered difficulties when attaching documents to cases.

Stakeholder engagement

4.55 The Taxpayers' Charter states that:

In most circumstances, we will tell you about a review or audit before we visit you. We send a letter, normally to the address where you have asked us to send your mail. Sometimes we will contact you by phone first to arrange an interview time.⁹⁵

The Charter also commits the ATO to 'clear and ongoing engagement' with taxpayers in audits with complex legal issues.⁹⁶

4.56 The PGH business line procedures for audits and reviews require active compliance officers to contact taxpayers by telephone to: advise of their selection for audit or comprehensive risk review; explain the scope of the audit or review; and arrange an initial interview. The procedures also require staff to follow-up telephone contact with a notification letter. The ATO also aims to send taxpayers a finalisation letter within seven calendar days of making a decision on the audit or review, and this requirement is reflected in PGH procedures.

4.57 The ATO's performance against these three client contact requirements is summarised in Table 4.12. It shows that only 12 per cent of audits and 10 per cent of comprehensive risk reviews recorded an initial telephone call to the taxpayer before a notification letter was sent. Notification letters were recorded in 68 per cent of audits and 77 per cent of comprehensive risk reviews.

95 ATO, *Taxpayers' charter: If you're subject to review or audit*, April 2013, available from <<http://www.ato.gov.au/About-ATO/About-us/In-detail/Taxpayers--charter/Taxpayers--charter---if-you-re-subject-to-review-or-audit/>> [accessed 10 January 2014], p. 6.

96 *ibid.*, p. 4.

Table 4.12: ATO contact with HWI taxpayers selected for audit and comprehensive risk review

Activity	Completed cases that achieved ATO client contact requirements		
	No. (%)		
	HWI contacted by telephone recorded	HWI notification letter recorded	Finalisation letter sent within seven calendar days
Comprehensive risk review (219)	22 (10%)	169 (77%)	175 (80%)
Audit (25)	3 (12%)	17 (68%)	18 (72%)
Total (244)	25 (10%)	186 (76%)	193 (79%)

Source: ANAO analysis of ATO data.

4.58 The ANAO analysis of a sample of HWI cases identified that only 72 per cent of audits and 80 per cent of comprehensive risk reviews recorded having sent a finalisation letter. This indicates that many HWI finalisation letters may not be recorded in the case management system.

4.59 In discussions with HWI representatives, more than half indicated the ATO could improve communication.⁹⁷ Stakeholders emphasised the importance of phone contact and face-to-face meetings instead of letters, especially for document requests and to provide the ATO with an oral explanation of financial transactions or situations that may seem, in the first instance, inconsistent with the HWI tax position. They indicated the value of direct communication to clarify the ATO questions and to be in a better position to adequately address ATO requests. Although stakeholders noted that the ATO had generally taken their feedback into consideration, they also believed that more direct and earlier communication would make it easier to negotiate with the ATO, resolve cases faster and result in better outcomes for both parties.

⁹⁷ Eight of 14 stakeholders participating in teleconferences with the ANAO reported that the ATO could improve communication. The ANAO also examined complaints lodged by HWIs. Four complaints were managed by the PGH business line between 1 September 2009 and 30 June 2013 relating to audit processes and outcomes.

Conclusion

4.60 HWI compliance work is often complex: dealing with complicated business and tax affairs, with little information on business and financial structures available publicly. At the same time, HWI compliance work contributes strongly to the financial results of the PGH business line, and more generally to the ATO's revenue from compliance activities. Compliance work on a target population of only 2600 HWIs generated 54 per cent of the liabilities raised and 41 per cent of the cash collected by the PGH business line for 2012–13. In this context, conducting effective voluntary and active compliance work is critical.

4.61 The ATO has actively engaged with HWIs and their representatives to raise awareness of their tax rights and obligations. The ATO website provides considerable information and resources specifically for HWIs, including on the ATO's compliance strategy. Further, ATO executives have communicated and engaged directly with the HWIs and their representatives in numerous forums, and the media have relayed the ATO's message in general and specialised publications.

4.62 In relation to active compliance work, the ATO has conducted a large number of audits and reviews that have generated around \$852 million in cash collections between 2009–10 and 2012–13. In conducting these activities, the ATO has covered a large proportion of the HWI population (over 90 per cent). However, most additional tax revenue was collected from a minority of cases (30 per cent of audits and 16 per cent of comprehensive risk reviews).

4.63 A large proportion of reviews and audits finalised between 2009–10 and 2012–13 did not achieve the cycle time standard: almost one third of preliminary risk reviews, half of comprehensive risk reviews and almost half of the audits. Some cycle times are very long which provides management challenges for the ATO, and extends the compliance cost for the taxpayer. Assessing staff effort to conduct specific HWI compliance activities against the time taken to complete these activities and the financial outcome would support the ATO to more efficiently allocate resources, and better demonstrate return on investment. There would also be benefit in the ATO calculating the return on investment using the amount of cash collected following compliance activities, in addition to the liabilities raised. Further, the ATO does not currently cost the time spent by staff on HWI compliance activities. The ATO could take steps to more accurately determine the cost of HWI compliance activities.

4.64 The ATO reviewed (and continues to revise) its business model and processes, with a view to improving the effectiveness of compliance activities, particularly in relation to timeliness, staff capability, technical support, engagement with taxpayers and the soundness of decisions. Despite this work, there is still room for improvement in a number of areas:

- reviews and audit take considerable time to complete, and in a large proportion of cases, significantly exceed the ATO-determined cycle time. However, the longer cases yield the better financial outcomes;
- there are some weaknesses in the recording of key documents and approvals on the ATO's case management system; and
- direct engagement and communication with HWIs and their representatives is encouraged by the ATO and strongly appreciated by the HWIs' representatives. However, it does not take place as systematically as prescribed in ATO processes, and as desired by HWI representatives.

5. Objections and Appeals

This chapter examines the ATO's handling of objections and appeals against amended assessments lodged by HWIs.

Introduction

5.1 The legislation gives taxpayers the right to object to some decisions the ATO makes about their tax affairs, including when issued with an amended assessment following a compliance activity. When this occurs, the ATO conducts an independent internal review. The time limits governing how long taxpayers have to object to an ATO decision vary depending on the type of decision. HWI taxpayers, in most cases, have 60 days to object to an amended assessment.⁹⁸ Objections raised by HWIs are managed by the PGH Interpretative Assistance branch.

5.2 If taxpayers disagree with the result of the objection, they are able to apply to the Administrative Appeals Tribunal (AAT) or the Federal Court of Australia for an independent external review.⁹⁹ Appeals lodged by HWIs are dealt with by the Review and Dispute Resolution business line which is part of the Law Design and Practice group.

5.3 The ANAO examined the management of the ATO's objection and appeal processes in place should HWIs dispute an assessment following an active compliance activity.

98 ATO website, *Dispute (object to) an ATO decision*, available from [http://www.ato.gov.au/General/Correct-a-mistake-or-dispute-a-decision/Dispute-\(object-to\)-an-ATO-decision/](http://www.ato.gov.au/General/Correct-a-mistake-or-dispute-a-decision/Dispute-(object-to)-an-ATO-decision/) [accessed 15 January 2014].

99 While an external review is normally first taken to the AAT, and then the Federal Court, in some cases taxpayers can apply directly to the Federal Court. A review can then proceed to the High Court in some circumstances.

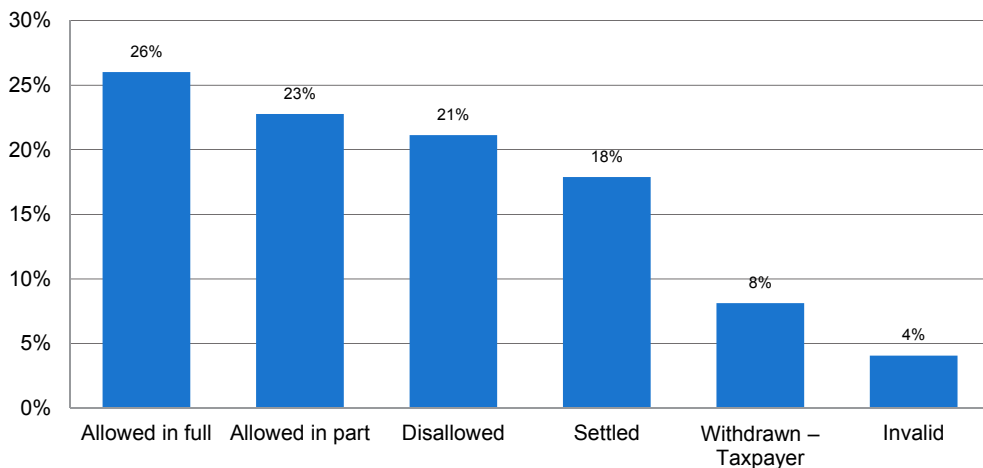
Objections

Objection outcomes

5.4 For the two years 2011–12 and 2012–13¹⁰⁰, HWI taxpayers lodged 123 objections following a compliance activity (65 in 2011–12 and 58 in 2012–13). This represented an estimated objection rate of 65 per cent on average for the two years.¹⁰¹

5.5 As a result of the objection process, almost half (49 per cent) of the objections gained a positive outcome for HWIs, either because they were allowed in full (26 per cent) or in part (23 per cent) (Figure 5.1).

Figure 5.1: Outcomes of HWI objections finalised in 2011–12 and 2012–13



Source: ANAO analysis of ATO data.

¹⁰⁰ It was only possible to analyse data for these two years as prior to 2011–12 the ATO did not record whether the objections were lodged following compliance activity.

¹⁰¹ The ANAO calculated the objection rate by dividing the total number of completed compliance cases that raised a tax liability by the number of completed objections for 2011–12 and 2012–13. Conducting this comparison year to year provides an estimate only as approximately one year is likely to have elapsed between the date a compliance case is completed and the date an objection case is completed. However, a level of assurance in the reliability of this result is given as the number of completed compliance cases was comparable for the four consecutive years 2009–10 to 2012–13.

5.6 The ATO has recognised the benefits of resolving tax disputes early and in the simplest and most cost-effective manner, to minimise the time and resources involved in disputes.¹⁰² Through initiatives such as the Integrated Approach to Dispute Resolution, the ATO seeks to avoid litigation and resolve disputes before they escalate to the objection or appeal stages, as close to the time of the original decision as possible.¹⁰³ The ATO also supports the settlement of tax disputes for appropriate cases, including through the use of alternative dispute resolution, and has published a Code of Settlement Practice¹⁰⁴ that provides guidance about situations in which settlement could be considered.¹⁰⁵

5.7 This approach to dispute resolution is reflected in the proportion of HWI objections settled (18 per cent). In the case of settlements, the ATO advised that it is standard practice for neither party to concede their legal position. This means that, while the outcome may appear positive to the taxpayer who will have a reduced liability as a result of the settlement process, it does not necessarily reflect concession by the ATO in relation to any legal principle. For example, the settlement may reflect a factual uncertainty.

5.8 The total tax amount in dispute, for the two years, was \$909 million, of which the ATO amended the liability by \$477 million (52 per cent) in favour of HWIs (including amounts allowed through settlements¹⁰⁶) (Table 5.1).

102 ATO, Practice Statement PS LA 2007/23, *Alternative Dispute Resolution in ATO Disputes and Litigation*, 26 October 2010; and ATO, *Dispute management plan 2012–13*, available from <<http://www.ato.gov.au/General/Correct-a-mistake-or-dispute-a-decision/in-detail/Avoiding-and-resolving-disputes/ATO-approach-to-resolving-disputes/Disputes-policy/>>, [accessed 9 April 2013].

103 Inspector-General of Taxation, *Review into the ATO's use of early and alternative dispute resolution*, May 2012, p. 9.

104 ATO, *Code of Settlement Practice*, 23 December 2011, available from <<http://www.ato.gov.au/Tax-professionals/Legal-practitioners/in-detail/Objections-and-reviews/Code-of-settlement-practice/>>, [accessed 8 April 2014].

105 In line with the ATO's (and the PGH business line's) intent to resolve disputes early, the ATO advised that the number of HWI cases settled at all stages (pre-audit, audit, objection and appeal) has increased significantly, from 36 in 2011–12 to 104 in 2012–13.

106 The ATO advised that in 2012, three cases, accounting for over \$80 million, were allowed due to an early neutral evaluation process. This process involves an alternative dispute resolution practitioner (such as a senior counsel or a retired judge), that reviews both parties' legal argument and makes a finding that is not binding on either party. The ATO uses the early neutral evaluation process as a principle of good administration and as a way to mitigate litigation risks.

Table 5.1: Tax disputed in objections, 2011–12 to 2012–13

	Tax	Penalties	Interest	Total
Amount in dispute (\$m)	612	188	109	909
Liability reduction (\$m)	315	94	68	477
Percentage reduction (%)	52	50	62	52

Source: ANAO analysis of ATO data.

5.9 In 55 per cent of objections allowed, HWIs obtained between 76 per cent and 100 per cent of the disputed amount (including tax, penalties and interest) (Table 5.2).¹⁰⁷

Table 5.2: Proportion of disputed liabilities reduced as a result of objections being allowed in full or in part or settled, 2011–12 to 2012–13

Reduction in liability as a percentage of disputed amount	Objections allowed or settled		
	\$ million	No.	%
1% or less	0.0	7	10
2–25%	5.1	8	11
26–50%	9.7	8	11
51–75%	165.0	10	14
76–100%	297.2	40	55
Total	477.0	73	100

Source: ANAO analysis of ATO data.

5.10 In view of the high rate of objections, with around half of these cases being fully or partially successful, as well as the substantial proportion of the disputed amounts being granted to HWIs, the ATO provided the following explanations:

- HWIs are likely to object to the ATO decisions following a review or audit because many of the tax issues in question are complex, often untested by the courts and subject to interpretations that can be challenged; and
- a key challenge in auditing private entities is obtaining timely and complete information. One way to obtain this information is to issue an

¹⁰⁷ In almost all objections where penalties or interest were allowed (97 and 98 per cent respectively), HWIs had 76 to 100 per cent of the disputed amounts remitted.

amended assessment when the required information is not forthcoming. It is then the HWI's responsibility to prove that the decision is not justified or incorrect¹⁰⁸, by providing additional information at objection stage.

5.11 The Inspector-General of Taxation has also suggested that the HWI objection rate and the number of decisions upheld raised questions about the quality of audit work and the sustainability of ATO compliance decisions.¹⁰⁹ In this regard, since 2011–12, objection officers are expected to record, for each objection's outcome, the reason for the decision to allow or disallow the case. The ANAO analysed these reasons, where they had been recorded, for the 67 objections that had been allowed in full, in part, or settled in 2011–12 and 2012–13, and these are outlined in Table 5.3.

Table 5.3: Key reasons for ATO's decisions to allow (in full or in part) or settle an objection, 2011–12 and 2012–13

Reason category	Number	%
Compliance work was insufficient/incorrect	31	46
Additional information was provided by the HWI	18	27
Incomplete/insufficient evidence	12	18
ATO's application of law to the facts has changed (since initial decision)	6	9
Total	67	100

5.12 This analysis confirmed that HWIs often had not provided all available relevant information for the compliance activity (in 45 per cent of cases). It also identified that in more than half the cases where an objection had been allowed (55 per cent), the compliance decisions were at least partially incorrect, or the ATO had changed its application of the law.¹¹⁰

108 Sections 14ZZK and 14ZZO of the *Tax Administration Act 1953*. The Act defines a taxation decision as the assessment, determination, notice or decision against which a taxation objection may be, or has been, made.

109 Inspector-General of Taxation, *Review into the ATO's compliance approaches to small and medium enterprises with annual turnovers between \$100 million and \$250 million and high wealth individuals*, December 2011, pp. 55-56.

110 None of the objections for which compliance decisions were at least partially incorrect, or the ATO had changed its application of the law, had been settled.

Objection outcomes as an indicator of staff capability

5.13 The 2011 review by the Inspector-General of Taxation also identified ATO staff capability as a key concern and made five capability related recommendations.¹¹¹ One of these recommendations addressed the integration of HWI taskforce compliance staff into the active compliance teams and suggested that the ATO, while proceeding with the integration of the HWI taskforce, should maintain a degree of PGH compliance officer specialisation by taxpayer type or industry.

5.14 Following the Inspector-General of Taxation's report, the PGH business line developed a range of material to increase industry knowledge of staff, including eWiki material that highlights issues affecting taxpayers from an external perspective, and internal seminars and sessions. Staff can also access a library with webinars, podcasts, vodcasts, blogs and DVDs of internal conference events. Information on these programs has been circulated through a variety channels, including newsletter articles, information on the intranet and email updates.

5.15 The material complements the comprehensive suite of resources and support tools developed by the ATO to build and maintain the technical knowledge of staff. The ATO's legal database (available on the ATO's website) provides access to a wide range of information, including public rulings, ATO policy papers, law administration practice statements, and technical discussion papers. The ATO has also developed detailed guides for priority risks.

5.16 Integration of the HWI taskforce into the PGH business line created some challenges for HWI compliance work, including maintaining the staff specialisation required to deal with the complex HWI cases and loss of knowledge following the move away from the taskforce's client ownership model. The ATO has sought to address these challenges by implementing the recommendations on staff capability made by the Inspector-General, including developing a new model of engagement between the active compliance and Technical and Case Leadership teams.

5.17 Under the revised approach, compliance staff are encouraged (and in most HWI cases, mandated) to consult with a senior technical leader on a

¹¹¹ Inspector-General of Taxation, *Review into the ATO's compliance approaches to small and medium enterprises with annual turnovers between \$100 million and \$250 million and high wealth individuals*, December 2011. The report made 41 recommendations, 17 of which related to technical capability and support related issues.

case's specific aspects. The list of technical leaders, together with their area of specialisation, is accessible from the intranet, and compliance staff are invited to contact them directly, for a 'light touch' involvement such as an initial discussion, or for a more intensive input that will require the technical leader to examine the case and provide a written response. Compliance staff must also conduct 'workshops' with their team leader, at key steps of the audit or review process. Under this model of engagement, the PGH business line has also reintroduced client ownership for key taxpayers, including some HWI taxpayers. The ATO has developed a comprehensive range of materials and tools to assist in building staff capability, although it is up to individual staff members to access relevant information and complete identified learning and development needs.

5.18 As previously discussed, the ANAO conducted a series of consultations with accounting and law firms and industry representatives. Feedback indicated that the knowledge and competency of individual staff remains a concern and varies across reviews and audits, but suggested that the calibre of individual staff has improved overall.

5.19 At the time of the audit, feedback from ANAO interviews with active compliance staff indicated that former officers of the HWI taskforce continued to work almost exclusively on HWI audits and reviews.¹¹² The views of these staff varied in relation to the level of mentoring and support provided under the new arrangements; while some felt access to technical support had improved, others raised difficulties in identifying the technical officer with the correct expertise and questioned whether the advice provided was always helpful or relevant. However, almost half of all staff interviewed, including less experienced staff, advised that they had received support from other members of their active compliance team, by way of formal or informal discussions about the more complex aspects of a case.

¹¹² To develop an understanding of managing HWI audit and review cases, the ANAO interviewed 31 active compliance officers across three sites.

5.20 In light of the incidence of incorrect compliance decisions, as reflected in the results from the objections data, there would be merit in the ATO:

- allocating the most complex HWI cases to the more experienced compliance officers;
- continuing its efforts to develop HWI staff capability; and
- monitoring the level of effectiveness of current initiatives to improve staff capability and technical support, including by analysing the level of take up of these initiatives.

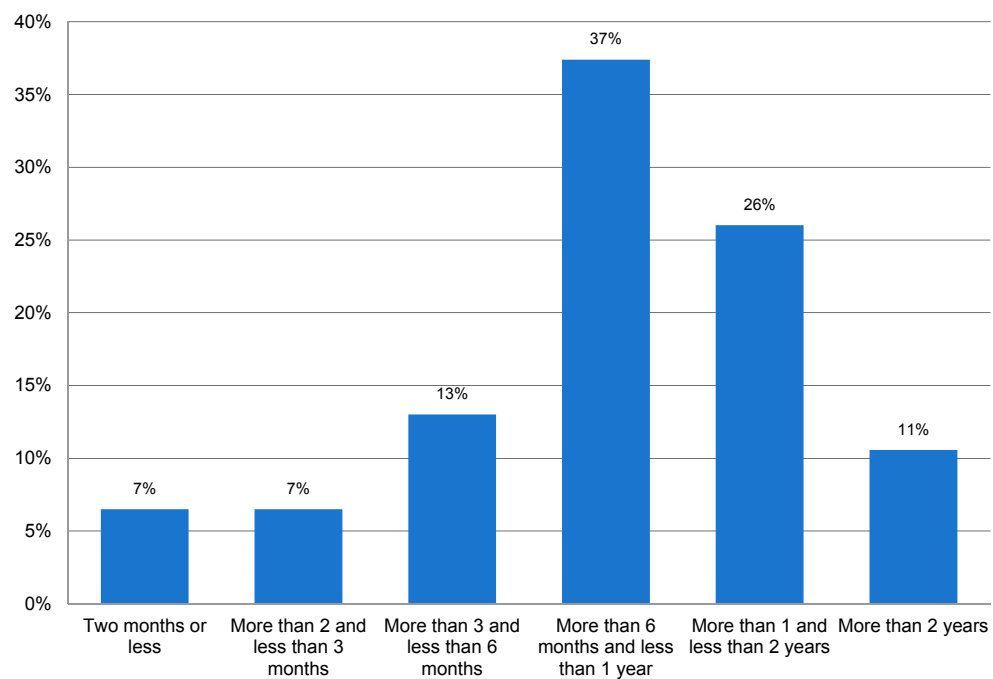
ATO timeliness in finalising objections

5.21 The primary service standard for finalising objections across the ATO is to provide a decision within 56 calendar days of receiving all necessary information. If needed, further information is requested within 14 days, and the ATO endeavours to contact taxpayers within 14 days of receiving the information to negotiate a new finalisation date. The service standard for 2012–13 was 70 per cent of objections finalised within the negotiated due date.

5.22 The ANAO examined the ATO's timeliness in finalising objections for 2011–12 and 2012–13. A time extension was negotiated in 114 (93 per cent) of the 123 cases completed during these two years, and the ATO finalised the objections within the negotiated period in 98 per cent of cases.

5.23 Figure 5.2 presents the time taken to finalise objections. It shows that more than one in three objections required more than a year to finalise. The ATO took an average of 352 days to finalise the objections. The complexity of HWI compliance cases, in addition to the frequent need to request additional information that may require some time to collect and analyse, partly explains the time taken to finalise objections. The ATO also advised that in some instances it is in the taxpayer's interest to delay the date for finalising objections, as they may encounter problems in obtaining required information, or be away on business activities. Anecdotally, some taxpayers would also rather the objection process be extended in order to delay full payment of their liability until the objection is finalised.

Figure 5.2: Time taken to finalise objections, 2011–13



Source: ANAO analysis of ATO data.

5.24 For the 65 per cent of HWI taxpayers who lodged an objection to their amended assessment following a review or audit, the time taken to finalise an objection adds to the time that was taken to finalise the overall process. These HWIs will typically be uncertain of their final liability for over one thousand days (for audits) and over 600 days (for reviews).

Appeals

5.25 Prior to 1 July 2012, the IT systems recording litigation cases did not capture the Tax File Number of a case, and did not identify whether a case involved a HWI.¹¹³ Because of these limitations, the number of cases examined was restricted to the cases created and finalised in 2012–13, and it was not possible to calculate the proportion of objections by HWI taxpayers that are appealed to the AAT and Federal Court of Australia. The data available is presented in Table 5.4.

¹¹³ Since July 2012, litigation cases are recorded on the ATO electronic record management system.

Table 5.4: Administrative Appeals Tribunal and Federal Court of Australia HWI compliance appeal cases, 2012–13

	AAT	Federal Court of Australia
Number of cases		
Appeal cases on hand at 1 July 2013	5	6
Appeal cases finalised 1 July 2012 to 30 June 2013	14	4
Finalised case outcomes		
Settled	9	2
Conceded by ATO	4	1
Conceded by taxpayer	1	-
Favourable to ATO	-	1
Total	14	4

Source: ANAO analysis of ATO data.

Note: 'Conceded' refers to a matter finalised prior to hearing; 'Favourable' refers to a matter finalised at hearing.

5.26 This data shows that the majority of appeals to the AAT and the Federal Court of Australia were settled (nine out of 14 AAT cases; and two out of four Federal Court of Australia cases). This reflects the ATO's decision to encourage the negotiation of settlements with the taxpayer, rather than undertake lengthy and expensive court processes.

Conclusion

5.27 Approximately 65 per cent of HWI compliance decisions were subject to an objection in 2011–12 to 2012–13, of which around half resulted in a reduced liability. In more than half the cases where an objection had been allowed or settled, the ATO recorded that the compliance decisions were at least partially incorrect, or that the ATO had changed its application of the law.

5.28 From a timeliness perspective, three in four objections took more than six months to finalise in 2011–12 and 2012–13. HWI objection work, like HWI compliance work, is in most instances complex, requires a high level of staff expertise and is likely to take considerable time to complete. As a large percentage of HWIs appeal their compliance decision, the time and resources expended in responding to the ATO is substantial, with financial and potential business consequences.

5.29 Delivering soundly-based compliance decisions is both a priority and a desired outcome for the ATO, particularly given the considerable time and resources expended on HWI compliance activities. Objection data suggests that, despite the time taken to complete compliance work, a large number of objections were allowed or settled. While the reasons for this outcome are varied and include, significantly, the provision of additional facts and evidence after the completion of compliance activities, it may also reflect that some initial compliance decisions are not soundly based. The work being undertaken by the ATO to improve the capability of compliance staff and the increased use of alternative dispute resolution processes may, in turn, positively impact on completion timeframes and outcomes.

6. Measuring Compliance Effectiveness

This chapter examines the ATO's monitoring and reporting of the performance of HWI compliance strategies and activities in mitigating compliance risks.

Introduction

6.1 Since 2008, the ATO has used a compliance effectiveness methodology (CEM) to measure the impact of its compliance strategies on treating specific compliance risks.¹¹⁴ The methodology is an iterative, workshop-centred approach based on two key elements: the identification of measurable compliance objectives; and the articulation and treatment of the risks to achieving these objectives.

6.2 To examine how the ATO measures and reports on its HWI compliance activities, the ANAO examined the:

- application of the CEM to HWI compliance risks; and
- external and internal monitoring and reporting of HWI compliance strategies and activities.

Applying the Compliance Effectiveness Methodology to HWI compliance risks

6.3 The CEM has four phases: identifying risks; developing success goals and strategies; developing indicators; and determining effectiveness. The first two phases centre on effectiveness planning and the third and fourth on evaluating effectiveness.

6.4 The outcomes of the first three phases are presented to the risk owner and the business line Risk Management Committee or executive for endorsement before progressing to the fourth phase. The outcomes of the fourth phase are also reported to these decision makers, and the ATO uses the results to inform future planning and improvements to compliance

¹¹⁴ At the time of this audit, the ANAO was also conducting a performance audit of the ATO's Compliance Effectiveness Methodology. This audit is expected to table in the Winter 2014 session of Parliament.

approaches.¹¹⁵ Business and service lines are required to conduct ongoing evaluations after the final phase is completed, although the timing of these reviews is determined by the business line risk managers, in consultation with the Risk Management Committee or executives.

6.5 The methodology has been applied on three occasions to the ATO's HWI compliance work: in 2007 as part of the CEM pilot; in 2009 for the first time under the approved CEM program; and in 2012 when an updated CEM evaluation was completed. The ATO also planned to conduct the CEM in 2014 (which was not commenced at the time of the ANAO audit).

Pilot of the methodology in 2007

6.6 The HWI taskforce was one of two areas chosen to pilot the CEM—the other was in relation to tax haven compliance risks.¹¹⁶ The pilot studies involved workshops to develop an understanding of risks, drivers, strategies and potential effectiveness indicators, and were completed in July 2007.

6.7 While not specifically addressing these issues, the report on the HWI project noted that the pilot had not come to a definite conclusion on the effectiveness methodology or the effectiveness of compliance activities in addressing HWI compliance risks. However, it found that the exercise had been valuable, for example, in highlighting the importance of having regard to capital gains when assessing the tax performance of HWI groups. It concluded that a more complete picture needed to be developed and warned that sufficient resources needed to be allocated for this purpose. Together, the two pilot applications allowed the ATO to develop and test potential effectiveness measures. The pilots also demonstrated the potential of the methodology, which was subsequently implemented across the ATO.

Evaluation of compliance effectiveness in 2009

6.8 The 2009 CEM evaluation was conducted using an approved process. Initially there were three success goals for HWI compliance activities:

¹¹⁵ ATO, *Measuring Compliance Effectiveness—Our Methodology*, 2008, available from <<http://www.ato.gov.au/About-ATO/About-us/In-detail/Key-documents/Measuring-compliance-effectiveness---our-methodology/>>, [accessed 13 January 2014].

¹¹⁶ These two topics were chosen because they were relatively new projects, had a high profile and were subject to additional government funding.

- HWIs voluntarily meet their tax obligations;
- the ATO identifies and risk assesses all HWIs; and
- improved community confidence that HWIs pay their fair share of tax.

6.9 Individual success goals were measured against defined compliance effectiveness indicators that comprised a mix of quantitative measures, to enable assessment of HWI compliance against key taxpayer obligations, and qualitative measures, to enable assessment of community confidence.¹¹⁷ As part of the process, the ATO conducted a validation process on some indicators, and abandoned a proposed indicator in relation to collectable debt as unworkable. However, the ATO did not document an assessment of each proposed indicator according to the 'SMART' criteria, as required under CEM guidelines.¹¹⁸

6.10 The CEM did not provide an overall rating of compliance effectiveness. However, it rated the ATO as 'overall effective' against the first and second success goals, with all indicators pointing to maintained or improved voluntary compliance among HWIs and a high level of new HWIs being risk assessed within two years of identification. In relation to the third success goal, the ATO was rated as having limited success following a decline in community confidence in the ATO's Community Perception Survey.¹¹⁹ While the CEM report noted a possible link between the shift in community perceptions and the global financial crisis and negative media coverage of some wealthy Australians, the report identified the need for vigorous application of communication strategies to improve community perceptions.

6.11 The results of the compliance evaluation were presented to the Risk Management Committee in December 2009. A number of strategies were proposed at that meeting, including: undertaking a major exercise to assess the

117 Quantitative measures included effective tax rates, on-time lodgment performance and the proportion of new HWIs risk assessed within two years of identification. Qualitative measures included risk ratings of the HWI population and changes in the tone of media articles regarding wealthy Australians and tax.

118 The SMART criteria are applied by the ATO to performance indicators. The criteria allow assessment of whether indicators are specific, measurable, achievable, relevant and time bound. Guidance stipulates that this analysis of indicators should be undertaken to validate that they are providing the information that is expected.

119 The Community Perceptions Survey aims to capture trend data to monitor community perceptions of the ATO and its administration of the tax system over time. The survey was first conducted in 1996, biannually to 1999 and annually thereafter. The evaluation noted that in 2009 there was a decrease in the community's view that the ATO was effective in dealing with tax cheats (from 73 per cent in 2008 to 67 per cent in 2009).

effectiveness of HWI information being collected and of the risk and compliance tool; enhanced education material; and the development of better approaches to identify and manage new HWI compliance risks. As previously noted, the ATO has since revised its risk and compliance tool to identify and manage new HWI compliance risks and updated its key publication, *Tax compliance for small to medium enterprises and wealthy individuals*. Other initiatives have included: two projects (in 2010 and 2014) to expand and confirm the available information pool to identify HWIs; an initiative to promote the uptake of Advance Compliance Agreements among HWIs in 2010; and the 2013 Taxpayer and Industry Ownership Strategy which re-introduced an account management approach to gather information on key HWIs.

Evaluation of compliance effectiveness in 2012

6.12 The ATO last reported on a completed effectiveness evaluation of HWI compliance risks in 2012. This evaluation involved revised compliance strategies, success goals and indicators, but was not a full application of the CEM methodology. There was no workshop to discuss key elements of Phases 1 and 2—to specify risks and define and develop strategies. Nor was there appropriate documentation to support the design and validation of the indicators as required under Phase 3 or to record the results of the evaluation in a detailed project report as part of Phase 4. Rather, the focus of the evaluation was ‘on telling the HWI story’.

6.13 The identified HWI risks remained largely unchanged from the risks initially identified in 2007, being:

- failure of HWIs to voluntarily comply with their tax obligations means that wealthy Australians do not pay their fair share of tax; and
- community perceives that wealthy Australians do not pay their fair share of tax and community confidence in the integrity of the tax system is eroded as a consequence.

6.14 In respect of success goals, two of the original goals were refined—that HWIs properly meet their tax obligations, and the community is confident that HWIs pay their fair share of tax. Another (identifying HWIs) became redundant with the ATO’s improved data mining capability. Minor consequential changes were also made to the effectiveness indicators, which continued to involve analysing quantitative measures such as lodgement rates and ratios of collectible debt, as well as comparing historical and current

performance data. Table 6.1 summarises the results reported by the ATO against each goal for these risks.

6.15 The 2012 review found improvements in effectiveness against all four success goals. However, as with the 2009 evaluation it did not make an overall conclusion regarding the ATO's effectiveness in addressing the risks of HWIs failing to voluntarily comply with their tax obligations and not paying their fair share of tax. The results of the review were presented to the Risk Management Committee in June 2012, with the chair commenting that the HWI risk strategy was 'heading in the right direction'.

Table 6.1: HWI compliance effectiveness success goals and indicators, and reported results, June 2012

Risks: The failure of HWIs to voluntarily comply with their tax obligations means that wealthy Australians don't pay their fair share of tax. The community perceives that wealthy Australians do not pay their fair share of tax and community confidence in the integrity of the tax system is eroded as a consequence.		
Success goals	Effectiveness indicators: Monitor trends in	ATO reported results ¹
HWIs properly meet the tax obligations relating to correct reporting, lodgement and payment.	On-time and non-lodgment, effective tax rates, 'compliance dividend' (direct flow-on), voluntary disclosures, private ruling requests and debt levels.	<ul style="list-style-type: none"> • Correct reporting—Improvements in the effective tax rates of HWIs and associated beneficiaries compared to other individuals. • Increase in numbers of voluntary disclosures. • Estimated compliance dividend of \$441 million since 2006. • Decline in on-time lodgement coinciding with the expansion of the HWI population and global financial crisis. • Approximately \$1 billion in disputed liabilities. • A shift away from collectable debt to disputed debt.
The community perceives that the ATO is effective in ensuring that HWIs are paying their fair share of tax.	Community Perception Survey and analysis of media articles, feedback from consultative committees.	<ul style="list-style-type: none"> • Increased community confidence. After consistently dropping from 2007 to 2010 (74 per cent to 67 per cent), the perception that we 'are effective in dealing with people and businesses avoiding large amounts of tax' has bounced back to 70 per cent in the 2012 survey.
Improved ATO internal capability in risk identification case management.	Number of objections upheld in ATO favour, amount of audit assessments under objection, IQF results, strike rates / return on investment.	<ul style="list-style-type: none"> • Refined data mining techniques has resulted in a significant increase in the number of taxpayers whose net wealth appears in excess of \$30 million. • Engaging technical expertise earlier in the audit process has contributed to a 12 per cent increase in objections upheld in the ATO's favour in two previous years.
The ATO meets commitments relating to liabilities raised and cash collections.	Active compliance liabilities raised and cash collected.	<ul style="list-style-type: none"> • Met or exceeded liabilities and cash collection targets.

Source: ATO.

Note 1: The 2012 evaluation drew on a range of data. The first outcome (success goal) used lodgement data from 2006 to 2010 to monitor lodgement trends and to calculate the compliance dividend, and data from 2009 and 2010 for voluntary disclosures. The second outcome drew on survey results from 2007 to 2012; the third drew on objections data from the previous two years; and the fourth drew on HWI active compliance outcomes between 2006–07 to 2011–12 (to May).

6.16 The review also identified areas of future focus for the HWI compliance work (Table 6.2). These areas largely continued the existing approaches and compliance strategies for HWIs.

Table 6.2: Key findings and areas of future focus for the ATO's HWI compliance activities—2012 compliance effectiveness evaluation

Key findings	Future compliance activities
The fall in on-time lodgements emphasised the importance of engaging with newly identified HWIs.	The ATO subsequently received additional budget funding in 2012–13 to increase lodgment enforcement activity on higher risk and newly identified HWIs. ¹²⁰
There was a direct link between the ATO's improved risk identification and risk treatment capabilities and increases in liabilities raised.	The ATO will continue to build its technical capability to identify, monitor and treat emerging risks.
Refined data mining techniques have identified a significant number of taxpayers whose net wealth appears in excess of \$30 million (potential HWIs).	The ATO started engaging with these newly identified potential HWIs in 2012–13.
Effectiveness of expanded compliance program has led to increased voluntary disclosures and improved effective tax rates.	No areas of future focus were identified.
Compliance dividend methodology demonstrates the effectiveness of ATO interventions in influencing improvements in voluntary compliance.	As effect can dissipate over time, ongoing monitoring and engagement across the HWI population is necessary.
There was a decline in community confidence (between 2007 and 2010) in the ATO's effectiveness in ensuring that HWIs pay their fair share of tax.	Ongoing community engagement on ATO HWI compliance activities is required.

Source: ATO.

6.17 A full CEM evaluation may have had more significant findings and proposals for revised strategies, with more detailed analysis of the indicators and the information underlying them. This may have resulted in proposed improvements to risk identification, case selection and active compliance activities.

120 The ATO was provided with \$37 million in the Mid-Year Economic and Fiscal Outlook Budget 2012.

Evaluation of compliance effectiveness in 2014

6.18 The ATO was developing planning documents to evaluate HWI compliance activities in early 2014 at the time of this ANAO audit. The planning documents indicate that, as with the 2012 evaluation, the evaluation will be largely a refresh of Phases 3 and 4, involving some refinement to success goals and indicators but not a full application of the CEM.

6.19 In refining the success goals, the ATO removed the goal that measured risk identification. Table 6.3 traces the evolution of success goals for the ATO's HWI compliance work between 2007 and 2013–14.

Table 6.3: Evolution of success goals, 2007 to 2014

2007	2009	2012	2014
<p>HWIs voluntarily meet their tax obligations.</p> <p>There is an improved perception of wealthy Australians paying their fair share of tax.</p> <p>All wealthy Australians are identified by the ATO and flagged accordingly.</p>	<p>HWIs voluntarily meet their tax obligations.</p> <p>There is an improved perception of wealthy Australians paying their fair share of tax.</p> <p>All wealthy Australians are identified by the ATO and flagged accordingly.</p>	<p>HWIs properly meet the tax obligations relating to correct reporting, lodgment and payment.</p> <p>Improved ATO internal capability in risk identification case management.</p> <p>The community perceives that the ATO is effective in ensuring HWIs are paying their fair share of tax.</p> <p>The ATO meets commitments relating to liabilities raised and cash collections.</p>	<p>HWIs understand their rights and obligations and willingly meet their income tax obligations, lodge, report and pay their tax on time.</p> <p>Improved compliance behaviour as a result of our differentiated and transparent approaches.</p> <p>Community confidence that HWIs pay their fair share of tax.</p> <p>Delivery on Government liabilities and cash collections commitments.</p>

Source: ANAO analysis.

6.20 Taken together, the success goals align with existing strategies to mitigate the HWI tax compliance risk.

Assessment of HWI compliance effectiveness indicators

6.21 The ANAO assessed the ATO's compliance effectiveness indicators for the last completed CEM evaluation (2012) against the ANAO's three key performance indicator (KPI) criteria¹²¹:

- relevant—indicators contribute to conclusions that assist users' decision making;
- reliable—indicators allow for reasonably consistent assessment of a program; and
- complete—a set of indicators that allow for the overall assessment of a program to inform users' decision making.

The indicators were assessed overall as relevant and reliable in measuring the impact of the HWI activity, as shown in Table 6.4.

Table 6.4: Results of ANAO testing of HWI compliance effectiveness indicators

Indicator	Relevant		Reliable	
	Focused	Understandable	Measurable	Free from bias
Monitor trend in on-time and non-lodgment, effective tax rates, 'compliance dividend' (direct flow-on), voluntary disclosures, private ruling requests and debt levels.	✓	✓	✓	✓
Monitor trend in Community Perception Survey and analysis of media articles, feedback from consultative committees.	✓	✓	✓	✓
Monitor trend in number of objections upheld in ATO favour, amount of audit assessments under objection, IQF results, strike rates / return on investment.	✓	✓	✓	✓
Monitor trend in active compliance liabilities raised and cash collected.	✓	✓	✓	✓

Source: ANAO analysis.

Notes: ✓ = met, or met some, of the criteria; ✗ = not met the criteria.

¹²¹ Following amendments to the *Auditor-General Act 1997* in 2011 that provided the Auditor-General with the explicit authority to audit the appropriateness of entities' KPIs and the completeness and accurateness of their reporting, the ANAO has developed a methodology to evaluate KPIs. This methodology is presented in ANAO Report No.28 2012–13, *The Australian Government Performance Measurement and Reporting Framework Pilot Project to Audit Key Performance Indicators*, April 2013, p. 63.

6.22 In relation to completeness, the indicators cover many of the elements of performance required to assess the effectiveness of the ATO's strategies to address HWI compliance risks, covering trends in voluntary compliance, outcomes from active compliance activities and community confidence levels. However, there were no indicators relating to improving the legislation to reduce potential confusion in the application of the law by taxpayers and minimising aggressive tax planning. Further, the indicators did not adequately use information about the risk population that could be obtained from the extensive programs of HWI audits and risk reviews, or from the risk assessment tools.

6.23 The ATO seeks to measure improvements in voluntary compliance through indicators such as trends in the effective tax rate¹²², voluntary disclosures and the compliance dividend. The effective tax rate is a standard measure and simplifies comparisons among taxpayers or companies. The number and value of voluntary disclosures¹²³ is also a useful measure, reflecting instances where HWIs amend information previously provided to the ATO to bring their tax affairs into order. The compliance dividend¹²⁴ measures future tax revenue that would have been lost without a change in behaviour arising from active compliance interventions.¹²⁵ While the compliance dividend demonstrates that audits and reviews improve voluntary compliance, the ATO recognises that such improvements reduce over time necessitating ongoing monitoring and review of HWIs.

6.24 As well as the compliance dividend, other indicators demonstrating the effectiveness of HWI active compliance activities are the number of audit assessments under objection, number of objections upheld in the ATO's favour, strike rates and return on investment. These indicators aim to measure improved compliance behaviour as a result of the ATO's differentiated risk and active compliance activities. As indicated in paragraph 6.17, an assessment of these indicators did not lead the ATO to recognise the opportunities for

122 The effective tax rate is the average rate at which an individual's earned income is taxed. It is calculated by dividing total tax expense by taxable income.

123 A voluntary disclosure is when a taxpayer informs the ATO about a false or misleading statement they have made or a change that increases their tax or reduces their credits—without prompting, persuasion or compulsion by the ATO.

124 The compliance dividend measures the change in income tax return data for individual HWI cases that have generated outcomes for three consecutive years post audit, and compares these HWIs to their peers to determine if there has been a change in compliance behaviour.

125 The ATO reported a compliance dividend of \$441 million for HWI audit activities from 2006 onwards in the 2012 reporting year.

improving HWI risk identification, case selection and active compliance activities that the ANAO has identified through this performance audit.

6.25 The ANAO's analysis considered other measures relevant to assessing effectiveness. For example, the profile of financial outcomes from active compliance interventions, as presented in Table 4.4, were examined and showed that 90 per cent of cash collected was from the top third of all cases raising a liability, with only 10 per cent from the other two-thirds. This distribution suggests that a high proportion of the HWI population is compliant but also points to the need for further improvement in the identification and selection of cases for active compliance.

6.26 When assessing indicators of effectiveness of HWI compliance strategies, it would be beneficial for the ATO to examine the distribution of financial returns from active compliance activities, including the number of compliance cases with a return and the relative scale of those returns. There would also be merit in the ATO analysing the implications of compliance outcomes for risk management processes, in order to identify scope for improvements to compliance and risk strategies, and the systems and processes underpinning them.

6.27 In relation to the second specified HWI compliance risk¹²⁶, three questions specific to wealthy Australians were posed in a perceptions survey for the first time in 2013.¹²⁷ These questions will provide relevant information for the 2013–14 evaluation. This highlights that survey responses used in prior HWI effectiveness evaluations were not specific to HWIs and accordingly there was less confidence about their relevance to HWI compliance risks.

6.28 There was no documentation to support the validation of indicators used in previous HWI compliance evaluations. When implementing the CEM in 2014, there would be merit in the ATO documenting the analysis of the information provided by each indicator, in reaching an overall conclusion about compliance effectiveness.

6.29 The ATO advised that the overarching HWI strategy for 2013–18 was being updated, and that the consequent changes to the strategy would be

126 The risk that the 'community perceives that wealthy Australians do not pay their fair share of tax and community confidence in the integrity of the tax system is eroded as a consequence'.

127 The questions were: 'Are you aware of the ATO's Wealthy Individual Programs?'; 'How effective do you think these programs are?'; and 'Do you feel that the ATO effectively deals with the tax obligations of the rich in Australia?'.

reflected through specific and measurable indicators being used in the effectiveness evaluation for 2014–15 and beyond.

Reporting of compliance activities

6.30 There is limited external reporting of HWI compliance activities, although the ATO monitors and reports internally, particularly against deliverables such as revenue and other active compliance targets.

External reporting

6.31 There is no specific reference to the ATO's HWI compliance activities in the ATO Portfolio Budget Statements. However, the ATO's ongoing focus on HWIs since 1996 has resulted in HWI active compliance case numbers and revenue achievements being regularly reported in annual reports. For example, the *Commissioner of Taxation's 2012–13 Annual Report* included reporting on some HWI deliverables, such as the number of completed audits and reviews, liabilities raised and cash collections in 2012–13 and collectively for the previous four years, as well as the number of registered HWI settlements.¹²⁸

6.32 The ATO also reports snapshots of achievements against compliance KPIs in its annual Compliance Programs, detailing the number of completed audits and reviews, and total tax liabilities raised and total cash collections. The *Compliance Program 2012–13* included a feature on the ATO's active compliance activities and HWI results between 1996 and 2012.¹²⁹

Internal management reporting

6.33 The PGH business line monitors and reports compliance performance against deliverables such as revenue and other active compliance targets at the business line level and by region and population. The two key reports that monitor performance in meeting the main internal measures at the HWI population level are: the PGH financial year performance executive snapshot report, a key PGH governance report; and the PGH active compliance performance report, an operational report. Both reports are produced on a monthly basis.

128 ATO, Commissioner of Taxation, *Annual Report 2012–13*, October 2013, pp. 44, 45 and 58.

129 ATO, *Compliance Program 2012–13*, July 2012, pp. 54–55.

6.34 These reports allow the ATO to track performance of HWI compliance activities against internal deliverable targets, particularly timeliness, number of reviews and audits on hand and completed, compliance liabilities raised and cash collected. As shown in Table 6.5, the ATO exceeded the liability and cash collection targets from 2011–12 onwards. The ATO reported that it did not meet the annual liability and cash collection targets in 2009–10 as a number of significant HWI cases took longer than planned. These cases were finalised in 2010–11.¹³⁰ The HWI cash collections were also \$1.3 million short of the target of \$200 million in 2010–11. While the \$200 million cash collection target for 2011–12 and 2012–13 remained unchanged, cash collections exceeded the target by 69 per cent and 37 per cent respectively.

Table 6.5: ATO performance against HWI active compliance liability and cash collection targets, 2009–10 to 2012–13

Year	Liabilities (\$m)		Cash collected (\$m)	
	Plan	Actual	Plan	Actual
2009–10	482	364	337	42 ¹
2010–11	706	839	200	199
2011–12	665	888	200	337
2012–13	675	1 070	200	274
Total	2528	3161	937	852

Source: ATO PGH reports and ANAO analysis of ATO data.

Note 1: As mentioned in Table 4.8, for 2009–10, the ATO reported a cash collection of \$51 million, which was \$9 million more than in the data provided to the ANAO. The ATO advised that the difference was due to eight cases that were closed in 2008–09 but resulted in cash collected in 2009–10.

6.35 In February 2014, the PGH business line finalised a review of its internal reporting arrangements. The review had been commissioned by the PGH senior leadership and was aimed at improving the effectiveness and efficiency of internal PGH reporting. The ATO advised that as a result of the review, the reporting was more consistent, streamlined and reliable. The review also identified opportunities for consolidating the business line's reporting capabilities, which were still being considered for implementation at the time of the audit.

130 ATO, Commissioner of Taxation, *Annual Report 2010–11*, October 2011, p. 101.

Conclusion

6.36 The ATO has undertaken a CEM evaluation of HWI compliance activities on three occasions (in 2007, 2009, and 2012), and has planned another evaluation in 2014. The 2012 iteration of the CEM was largely a refresh of the existing approaches, with some refinements to the success goals and effectiveness indicators. None of the three completed evaluations have formed a view as to the overall effectiveness of compliance activities in addressing HWI compliance risks. Nevertheless, the general message, as reflected by the response of the Risk Management Committee to the 2012 evaluation, has been that the compliance strategies are ‘heading in the right direction’. There was considerable scope, however, for these evaluations to have better analysed effectiveness indicators, and underlying source information and processes, relating to active compliance activities. Such analysis could have facilitated the identification of more substantial opportunities to improve risk assessment, case selection and active compliance strategies and treatments—in a similar way to the ANAO’s audit findings.

6.37 Reflecting its status as an element of broader ATO compliance activities, HWI compliance activity is not explicitly identified in the Portfolio Budget Statements and there is only limited reporting of performance in annual reports and annual compliance programs. There is regular, ongoing internal monitoring and reporting of performance in meeting internal targets for HWI active compliance deliverables, particularly the number of compliance cases, liabilities raised and cash collected. The ATO advised that internal monitoring and reporting of HWI performance had improved following the finalisation, in February 2014, of a review of internal reporting arrangements within the PGH business line.



Ian McPhee

Auditor-General

Canberra ACT

4 June 2014

Appendices

Appendix 1: Agency Response



Australian Government
Australian Taxation Office

23 MAY 2014
9:30

Second Commissioner of Taxation

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

Dear Ms Cass

**RE: AUSTRALIAN NATIONAL AUDIT OFFICE PERFORMANCE AUDIT OF
Managing Compliance of High Wealth Individuals**

Thank you for your letter dated 30 April 2014 and for the opportunity to provide comments on the proposed report on *Managing Compliance of High Wealth Individuals*.

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

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

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

If you require further information on this matter, please contact Michael Cranston, Deputy Commissioner, Private Groups and High Wealth Individuals on (02) 9374 1428.

Yours sincerely

Neil Olesen
Second Commissioner
Australian Taxation Office

Date: 21 May 2014

Annexure 1

Rec	ANAO recommendation	ATO response
1	To improve the reliability of the Risk Differentiation Framework (RDF), the ANAO recommends that the ATO: analyses the outcomes of active compliance cases to assess the RDF's effectiveness in identifying those HWIs at higher risk of non-compliance.	Agree The ATO will continue to build upon our existing approaches to improve our risk assessment processes.
2	To enable the ATO to more efficiently allocate compliance activities resources across the Private Groups and High Wealth Individuals business line, and to more accurately demonstrate return on investment, the ANAO recommends that the ATO: <ul style="list-style-type: none"> a) better assesses the cost of compliance activities for the HWI population; and b) calculates the return on investment for HWI compliance activities using cash collected, in addition to liabilities raised. 	Agree

Annexure 2**Summary of ATO's response**

The ATO welcomes this report. In finding the ATO's compliance approach to be generally effective, the review recognises the challenges that the ATO has in managing tax compliance of HWIs. Such challenges include complex business arrangements, opportunities for aggressive tax planning, intricate structures, contentious tax issues, grey areas of the law and limited public disclosure of financial information.

While the review focussed on the four years to 30 June 2013, the ATO has made a number of significant improvements to its work in this area over the last 12 months.

We acknowledge there are further improvements to be made and the two recommendations will further assist with our improvements in this area.

Appendix 2: Integrated Scoring Model risk categories

Risk categories	Number of risk rules
Capital Gains Tax	10
Consolidation	10
Demergers ¹³¹	1
Division 7A ¹³²	9
Fringe Benefits Tax	6
Franking Credits ¹³³	1
Income tax—Other	5
International – Controlled Foreign Companies	9
International – Thin Capitalisation	5
International – Profit Shifting	17
International – Non Resident Withholding Tax	6
International – Other	1
Lodgement	7
Professional Firms	1
Research and Development	11
Revenue Losses	7
Self Managed Superannuation Funds	1
Tax and Economic Performance	4
Taxation of Financial Arrangements	9
Trusts	3
Total number of rules	123

Source: ATO documents.

¹³¹ A demerger is a form of restructure in which owners of interests in the head entity (for example, shareholders or unit-holders) gain direct ownership in an entity that they formerly owned indirectly (the 'demerged entity').

¹³² Division 7A of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936) is an integrity measure aimed at preventing private companies from making tax-free distributions of profits to shareholders (or their associates).

¹³³ A franking credit is a taxpayer's share of the income tax paid by a company on their profits from which the taxpayer's dividends or distributions are paid.

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Australian Taxation Office

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