

T h e   A u d i t o r - G e n e r a l

Audit Report No.3  
Performance Audit

# Assessable Government Industry Assistance

Follow-up Audit

Australian Taxation Office

A u s t r a l i a n   N a t i o n a l   A u d i t   O f f i c e

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Canberra ACT  
12 August 1998

Dear Madam President  
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit of the Australian Taxation Office in accordance with the authority contained in the *Auditor-General Act 1997*. I present this report of this audit, and the accompanying brochure, to the Parliament. The report is titled *Assessable Government Industry Assistance – Follow-up Audit*.

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

Yours sincerely



P. J. Barrett  
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/Glossary

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ACN	Australian Company Number
ACS	Australian Customs Service
AGIA	Assessable Government Industry Assistance
AGIP	Assessable Government Industry Payment
ANAO	Australian National Audit Office
ATO	Australian Taxation Office
CDSWG	Client Data Standards Work Group
DFR	Diesel Fuel Rebate
DFRS	Diesel Fuel Rebate Scheme
HOTSA	Health Of The System Assessment
MAB/MIAC	Management Advisory Board /Management Improvement Advisory Committee
MOU	Memorandum of Understanding
PIB	Project Initiation Brief
RPS	Reportable Payments System
SBI	Small Business Income (ATO Client Service Line)
TFN	Tax File Number

# Summary and Recommendations



# Audit Summary

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## Introduction

1. Assessable Government Industry Assistance (AGIA) includes various grants, bounties, rebates and subsidies paid by the Commonwealth that are assessable income in the majority of circumstances in which they are received by taxable groups.

2. *Audit Report No.16 of 1995-96 Assessable Government Industry Assistance* (referred to as the 1996 Audit Report) tabled in April 1996, examined whether the Australian Taxation Office (ATO) had implemented the appropriate balance of compliance strategies to ensure that AGIA is adequately identified, disclosed to the ATO, and the revenue collected in an efficient and administratively effective manner.

3. The 1996 Audit Report focused on rebates paid under the Diesel Fuel Rebate Scheme (DFRS) because it is a significant form of AGIA and therefore has significant potential impact on Commonwealth revenue. The report found that the ATO had limited compliance strategies to ensure that AGIA was identified and disclosed and that the appropriate level of tax was collected. The Australian National Audit Office (ANAO) concluded with regard to DFRS, that a risk to revenue existed and that improved compliance management would yield significant results. The ANAO made eleven recommendations to improve the ATO's administration and increase the amount of tax revenue collected from AGIA. The recommendations relate primarily to administrative arrangements, taxpayer education, and enforcement activities.

## Follow-up audit

4. The objective of this follow-up audit was to report on the action taken by the ATO in addressing the recommendations of the 1996 Audit Report. The ANAO considered it timely to conduct a follow-up audit as the ATO has had substantial opportunity to have either fully implemented the recommendations contained within the report or to have made significant progress towards their implementation. The follow-up audit process also reinforces the ANAO's commitment to improving public administration and accountability through monitoring the progress of audit recommendation implementation. It is apparent that accepted recommendations are only effective when actually implemented. Improved performance is clearly forgone by partial, unnecessarily delayed or quasi-implementation.

5. In responding to the 1996 Audit Report recommendations, the ATO commented that the implementation of a number of recommendations would be dependent upon the results of implementing Recommendation No.1. This recommendation involved the ATO undertaking a risk assessment of the likely extent to which assessable Diesel Fuel Rebate (DFR) and other AGIA are not being reported by recipients in their tax returns. The ANAO was cognisant of this dependency in assessing the action taken by the ATO in implementing the recommendations contained in the 1996 Audit Report.

## Overall conclusion

6. The ANAO found that the ATO had taken effective action to address the recommendations of the 1996 Audit Report. Most recommendations have been implemented or are in the process of being implemented. However, recommendations 3 and 5 concerning improved taxpayer education are yet to be implemented.

7. Importantly, the ATO has implemented Recommendation 1 by undertaking a risk assessment of the extent to which DFR is not being declared by recipients in their tax returns. As a result of this risk assessment, the ATO has estimated that non-reported DFRS rebates represented a potential (upper bound) \$14 million loss to revenue in relation to the 1994-95 taxation year. This estimate provides some dimension to the 1996 Audit Report finding that a risk to revenue existed.

8. The ANAO also found that the ATO had extended the scope of recommendations in the 1996 Audit Report by including an Assessable Government Industry Payment (AGIP) business label in the income block of all tax return forms for the 1998 year. The ATO considers AGIP should include assessable payments received from all government sources. This includes the narrower payment category of AGIA. The ATO has estimated that AGIP amounts to over \$10 billion per annum in assessable income. The inclusion of the AGIP business label in tax return forms should assist the ATO to determine more accurately the nature and dollar value of reported AGIP and thus better focus its AGIP compliance strategies, including through data matching.

9. As noted in the 1996 Audit Report, data matching can be an effective compliance strategy offering considerable benefits in terms of increased compliance, additional revenue and lower administrative costs. While the ANAO found the ATO has undertaken further work in this area, scope exists for the ATO to make more effective use of data matching in relation to AGIP. For example, the introduction by the ATO of a new AGIP business label in tax return forms should facilitate matching AGIP information held

by government agencies with amounts disclosed in the tax returns of recipients to better determine the completeness of AGIP disclosure. This would allow the ATO to better focus its education and enforcement activities. The ANAO recognises that data matching is a sensitive issue, particularly to the Parliament and involves important privacy considerations. Accommodation of such concerns is necessary while achieving the significant benefits associated with data matching.

10. As a result of the follow-up audit, the ANAO has made six recommendations primarily aimed at improving aspects of the ATO's compliance activities for the collection of tax revenue from AGIP. These include providing better educational information to taxpayers in relation to AGIP and improving other relevant compliance strategies. The ATO agreed with all recommendations, including one with qualification.

# Recommendations

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*Set out below are the ANAO's recommendations arising from this report, with report paragraph references and the ATO's abbreviated responses. More detailed responses are shown in the body of the report. Recommendations 3, 4, and 5 have the highest priority.*

**Recommendation No. 1**  
**Para. 2.12**      The ANAO recommends that the SBI business line ensures that project milestones and costs associated with future projects are regularly monitored and updated to improve project control and accountability.  
*ATO response:* Agreed.

**Recommendation No. 2**  
**Para. 2.19**      The ANAO recommends that the ATO clearly identifies existing AGIP programs and regularly updates information relating to these programs to facilitate ATO compliance improvement initiatives.  
*ATO response:* Agreed.

**Recommendation No. 3**  
**Para. 2.26**      The ANAO recommends that the ATO reviews its instructions accompanying return forms, and its supplementary publications, to assist taxpayers in correctly declaring AGIP by explaining when, and in what circumstances, government industry payments are assessable income in the hands of recipients.  
*ATO response:* Agreed.

**Recommendation No. 4**  
**Para. 2.30**      The ANAO recommends that the ATO improves its use of other government publications and forms (for example, promotional material and application forms for AGIP) as leveraged education tools in relation to AGIP.  
*ATO response:* Agreed.

**Recommendation No. 5**  
**Para. 2.47**      The ANAO recommends that, in the absence of compatible data exchange protocols, the ATO continues to develop its use of data cleansing and re-formatting software to address externally sourced data compatibility problems.  
*ATO response:* Agreed.

**Recommendation No. 6**  
**Para. 2.53** The ANAO recommends that the ATO undertake further compliance research in relation to AGIP and, based on the results obtained, develop and implement appropriate compliance improvement initiatives to enhance the disclosure of AGIP in the income tax returns of recipients.

*ATO response:* Agreed with qualification.



# Audit Findings and Conclusions



# 1. Introduction

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## Audit objective, scope and cost

**1.1** The objective of this follow-up audit was to report on the action taken by the ATO in addressing the recommendations of the 1996 Audit Report. The audit was conducted from December 1997 to April 1998. Field work was undertaken at the ATO's National Office in Canberra and in the Sydney CBD Office. Officers from the Australian Customs Service (ACS) in Canberra were also interviewed.

**1.2** The follow-up audit was conducted in conformance with the ANAO Auditing standards and cost approximately \$95 000.

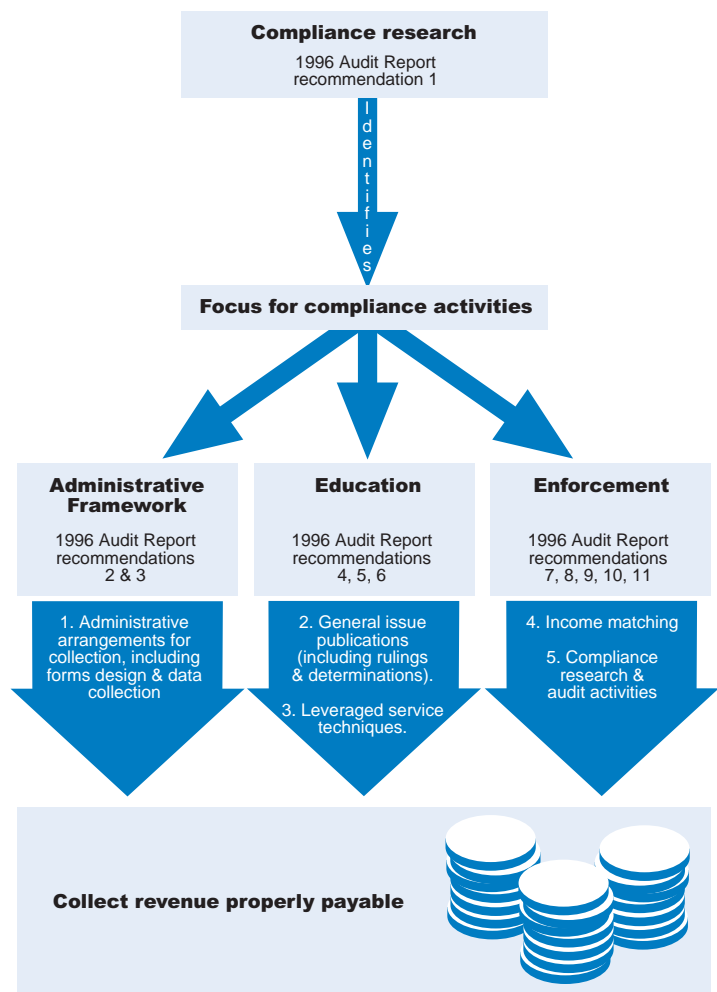
## Report structure

**1.3** This report is structured along the lines of the 1996 Audit Report which reported on ATO compliance activities in relation to AGIA, including:

- compliance research;
- the administrative framework;
- education activities; and
- enforcement activities.

**1.4** Figure 1 illustrates this framework, together with the five key areas within the framework, which were reviewed by the ANAO as part of both the original and follow-up audits.

**Figure 1**  
**Audit Report Structure**



1.5 For ease of identification, and where appropriate, throughout this report the 1996 Audit Report findings are highlighted with a grey background and the 1996 Audit Report recommendations are indicated with a blue background.

## Background

1.6 The ATO is the Commonwealth’s principal revenue collection agency. Its purpose is to ‘*collect revenue, properly payable, so as to fund services and support for the people of Australia.*’<sup>1</sup> In 1996-97, the ATO collected approximately \$107□billion.

<sup>1</sup> Commissioner of Taxation, Annual Report, 1996-97, p. v.

**1.7** The ATO relies primarily on a self assessment system to determine the revenue properly payable. The adoption of a self assessment system influences the way the ATO needs to manage the risks to revenue, as non-compliance is likely where taxpayers are unaware or unsure of their obligations, or believe that the ATO's enforcement strategies are inadequate. To maximise revenue collections under a self assessment system, the ATO must adopt the appropriate balance of compliance strategies, comprising education and enforcement activities supported by appropriate administrative arrangements.

**1.8** One source of taxation revenue is AGIA which includes various grants, bounties, rebates and subsidies paid by the Commonwealth that are assessable income in the majority of circumstances in which they are received by taxable groups.

**1.9** The objective of the 1996 Audit Report was to ascertain whether the ATO had implemented the appropriate balance of compliance strategies to ensure that AGIA is identified, disclosed to the ATO, and the revenue collected in an efficient and administratively effective manner.

**1.10** The 1996 Audit Report focused on rebates paid under the DFRS because it is a significant form of AGIA and therefore has significant potential impact on Commonwealth revenue. The DFRS is administered by the Australian Customs Service (ACS) which approved 221 149 applications for the DFRS in 1996-97 amounting to over \$1.4 billion in payments<sup>2</sup>.

## Overall findings and conclusions of the 1996 Audit Report

**1.11** The 1996 Audit Report found that the ATO had limited compliance strategies to ensure that AGIA was identified and disclosed and that the appropriate level of tax was collected. The ANAO made eleven recommendations to improve the ATO's administration and the amount of tax revenue collected from AGIA.

**1.12** The recommendations related primarily to administrative arrangements, taxpayer education, and enforcement activities. The recommendations emphasised the potential benefits of data matching with external AGIA databases and seeking the cooperation of other government agencies for the purposes of targeting education and enforcement activities.

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<sup>2</sup> Australian Customs Service, Annual Report 1996-97, p. 83.

**1.13** The 1996 Audit Report highlighted that the ATO had not undertaken any compliance research into the risks to revenue and the level of compliance associated with the DFRS. Accordingly, a key ANAO recommendation was that the ATO undertake a risk assessment of the likely extent to which assessable DFR and other AGIA were not being reported by recipients in their tax returns (see paragraphs 2.1 to 2.13 of this report).

**1.14** In responding to the 1996 Audit Report recommendations, the ATO commented that the implementation of a number of recommendations would be dependent upon the findings from the risk assessment project. The ANAO was cognisant of this dependency in assessing the action taken by the ATO in implementing the recommendations contained in the report.

**1.15** Overall, the ATO responded to the 1996 Audit Report recommendations as follows:

ANAO Recommendation No.	ATO Response
1, 2, 4, 5, 6, 7, 9, 10	Agreed
3, 8	Implementation dependent on outcome of risk assessment
11	Implementation dependent on outcome of further compliance research

**1.16** Chapter 2 outlines action taken by the ATO in implementing the 1996 Audit Report recommendations.

## 2. ATO Implementation of Compliance Activity Recommendations

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### Compliance research

**2.1** Compliance research and risk assessment are important to tax revenue collection as they assist the ATO in determining the appropriate balance of compliance strategies to ensure that taxation revenue is collected in an efficient and administratively effective manner.

#### **Findings of the 1996 Audit Report**

Owing to insufficient relevant data, the ANAO was not able to estimate the level of compliance with respect to DFR income. However, the ANAO did estimate the sensitivity of the amount of attributable tax revenue to changes in compliance.

The 1996 Audit Report revealed that a 1 per cent increase in disclosure by companies, and a 5 per cent increase in disclosure by individuals receiving DFRs (for 1994-95 and the two previous years), would equate to a \$12 million increase in taxation revenue. Ongoing benefits of \$5 million per annum would be achieved in future years. The ANAO estimate used a lower rate of improved disclosure for companies than for individuals, since the ANAO considered that companies had a higher likelihood of disclosure of DFR due to their more sophisticated accounting systems and access to specialist tax advice. It was the opinion of the ANAO that a risk to revenue existed and that improved compliance management in this area would yield significant results.

#### **Recommendation No. 1**

The ANAO recommended that the ATO undertake a risk assessment of the likely extent to which assessable DFR and other AGIA were not being reported by recipients in their tax returns. Depending on the results of the risk assessment, the ATO was to review the benefits of committing resources for further compliance research.

The ATO agreed with this recommendation.

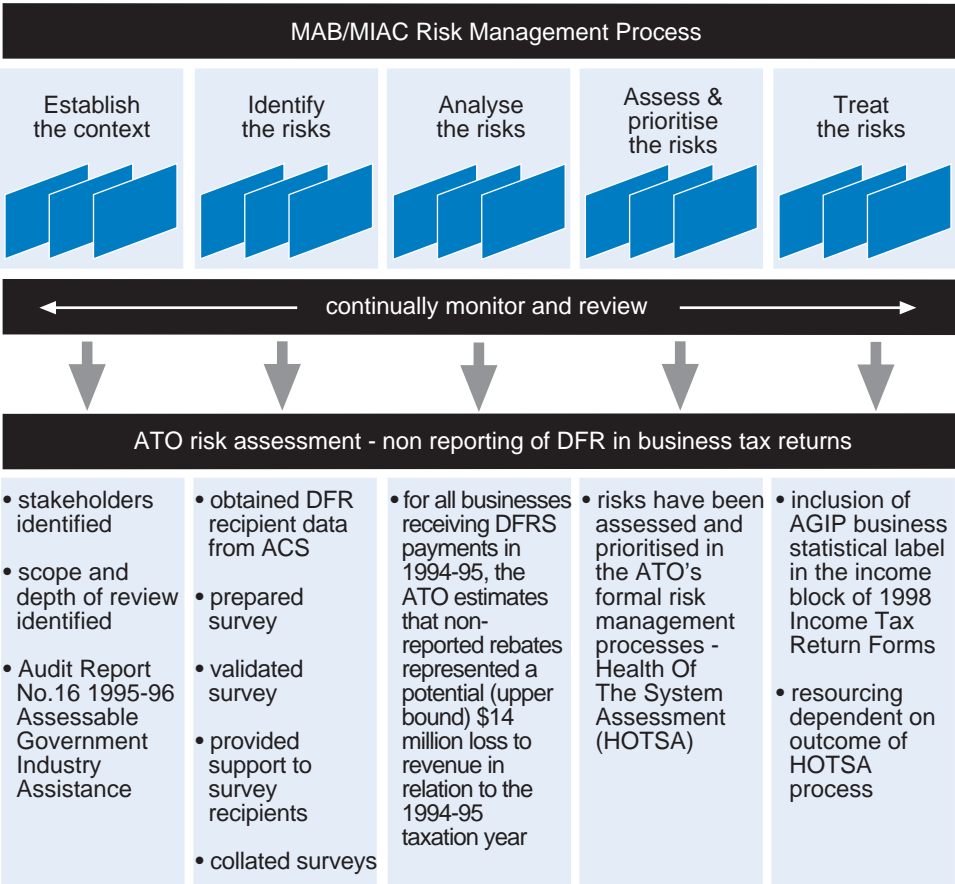
ATO implementation of the recommendation

*The process of managing risk*

2.2 To address this recommendation the Small Business Income (SBI) client service line within the ATO undertook a risk assessment project which focused on rebates paid under the DFRS. The ANAO assessed the ATO’s approach against the generic MAB/MIAC Risk Management Process model.<sup>3</sup>

2.3 Figure 2 provides a summary of the ATO’s approach in conducting its risk assessment project against the MAB/MIAC Risk Management Process model.

**Figure 2**  
**Comparison of ATO risk assessment project performance against MAB/MIAC guidelines**



<sup>3</sup> Guidelines for Managing Risk in the Australian Public Service, MAB/MIAC Report No.22, October 1996, p. 19.

*Identifying the risk*

**2.4** The ATO designed a survey to establish an (upper bound) estimate of the risk to taxation revenue. This approach was adopted instead of an audit based methodology because it was less costly and less intrusive, while still providing a sound basis for any subsequent audit or other action considered necessary. The ATO obtained data from the ACS 1994-95 DFR database to determine survey recipients.

**2.5** During the survey design phase, the ATO consulted key business and professional organisations to ensure the survey reflected typical commercial accounting practices relating to the reporting of rebates. Details of the survey are included at Appendix 1. The ATO distributed surveys by registered mail to over 1000 recipients of the DFR in February 1997.

**2.6** The ATO anticipated the survey results would provide information on three main types of non-reported DFRS rebates as follows:

- non-lodgement of tax returns;
- under reporting as such; and
- reporting in another year.

*Analysing the risk*

**2.7** The overall response rate to the survey was approximately 75 per cent, accounting for approximately \$600 million or some 50 per cent of all DFRS rebate payments made in the 1994-95 taxation year. ATO analysis of the survey results revealed that, for all businesses receiving DFRS rebates, there was a potential (upper bound) \$43 million or 3 per cent in non-reported rebates. The ATO advised that 3 per cent non-compliance rate by taxpayers (other than salary and wage taxpayers) would be regarded by most tax administrations as very low. However, in the case of DFRS rebates, the ATO considered the corresponding absolute dollar amount was significant. Assuming a taxation rate of 33 per cent, \$43 million in non-reported DFRS rebates would represent a loss to taxation revenue of approximately \$14 million.

**2.8** The ATO (upper bound) estimate of \$14 million provides some dimension to the ANAO finding in the 1996 Audit Report that a risk to revenue existed and that improved compliance management in this area would yield significant results.

*Assessing, prioritising and treating the risk*

**2.9** The ATO has assessed and prioritised the identified risk to taxation revenue in the context of its formal risk management process, the Health of the System Assessment (HOTSAs), which forms part of its strategic

planning framework process.<sup>4</sup> SBI risk management has been examined previously in *Audit Report No.19, 1997-98 Risk Management in ATO Small Business Income*. In that report the ANAO concluded that SBI's risk management process was sound.

**2.10** The ANAO considers the processes performed by the ATO in undertaking a risk assessment project to be consistent with the MAB/MIAC Risk Management Process model. The ATO risk assessment resulted in a comprehensive report which should assist the ATO to better focus its compliance activities in relation to the DFRS.

### *Project management*

**2.11** The ANAO found that the SBI business line had prepared a Project Initiation Brief (PIB) in relation to the risk assessment project. However, project milestones identified within the PIB had expired or been overtaken by events and had not been updated, suggesting that project milestones were not properly monitored or reported for sound project control and accountability purposes. Also, SBI had not estimated or monitored the cost of undertaking the risk assessment project. As a result, the ATO had incomplete information upon which to base an assessment of its project management performance.

## **Recommendation No. 1**

**2.12** The ANAO recommends that the SBI business line ensures that project milestones and costs associated with future projects are regularly monitored and updated to improve project control and accountability.

### *ATO response*

**2.13** The ATO agrees with this recommendation. The ATO recognises the value of regular monitoring and sound documentation for successful project management. Project control and accountability procedures have already been improved as part of the continuing development of SBI's risk management reporting protocols.

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<sup>4</sup> Audit Report No. 19 - Risk Management in ATO Small Business Income, p. 10.

## Administrative framework

### Findings of the 1996 Audit Report

The identification of AGIA income by the ATO is heavily dependent on that income being separately identified in the tax returns of recipients. The ANAO found no reference to DFR or other forms of AGIA in the relevant return forms and accompanying return form instructions.<sup>5</sup> Recommendations 2 and 3 in the 1996 Audit Report dealt with the need for the ATO to provide information to taxpayers on the assessability of AGIA and how it should be disclosed.

### Recommendation No. 2

The ANAO *recommended* that the ATO, as part of any subsequent compliance research, review the benefits of including on tax returns specific business statistical label(s) that seek data on AGIA.

The ATO agreed with this recommendation.

### ATO implementation of the recommendation

**2.14** The ATO considers AGIP to include assessable payments received from all government sources. This includes the narrower payment category of AGIA which itself includes assessable grants, bounties, rebates and subsidies. Examples of AGIA include the Diesel Fuel Rebate Scheme and Export Market Development Grants. The ATO has estimated that AGIP (which includes Medicare payments) amounts to over \$10 billion per annum in assessable income.

**2.15** The ANAO found that the ATO had extended the scope of Recommendation 2 of the 1996 Audit Report and included AGIP business labels in the income block of all tax return forms for the 1997-98 taxation year. The ATO advised that persons completing tax return forms were more likely to identify AGIP separately if the business label appeared in the income block of the return form rather than if the label appeared in the statistical block.

**2.16** The inclusion of an AGIP business label in tax return forms by the ATO:

- facilitates ATO data matching. This involves matching the data captured by the business labels in business tax returns with information provided to the ATO by government agencies administering AGIP;<sup>6</sup>

<sup>5</sup> The 1994 and 1995 Company Income Tax returns, Trust Estate Income Tax returns, Partnership Income Tax returns, the Taxpacks and the relevant return form instructions.

<sup>6</sup> Data would need to be available and exchange arrangements would need to comply with the Information Privacy Principles outlined in the *Privacy Act 1988*.

- identifies AGIP as being significant to the ATO. This is likely to encourage taxpayer compliance in declaring AGIP; and
- assists the ATO to determine more accurately the nature and dollar value of reported AGIP. This would assist the ATO in further focusing its compliance strategies to ensure that AGIP is identified and disclosed and that the appropriate level of tax is collected in an efficient and administratively effective manner.

**2.17** The ANAO considers the introduction of an AGIP business label by the ATO is likely to increase compliance in a manner that is cost-effective for taxpayers relative to previous arrangements for declaring AGIP.

**2.18** In order to identify the level of risk of taxpayer non-compliance in relation to the declaration of AGIP and to develop appropriate compliance strategies, the ATO must have knowledge of those programs comprising AGIP. The dynamic nature of AGIP programs means they are continually evolving in accordance with government policy. The ANAO found that the ATO did not have knowledge of all programs comprising AGIP and did not have a mechanism for updating its knowledge in this regard.

## Recommendation No. 2

**2.19** The ANAO *recommends* that the ATO clearly identifies existing AGIP programs and regularly updates information relating to these programs to facilitate ATO compliance improvement initiatives.

### *ATO response*

**2.20** The ATO agrees with this recommendation. Current AGIP information will be obtained as part of SBI's risk identification and assessment processes in 1998-99.

### Options for declaring DFRs

The 1996 Audit Report highlighted that the ATO allowed taxpayers three options in declaring DFRs:

- DFR included as part of business income;
- DFR offset against an appropriate identified expense item; and
- DFR returned as part of the reconciliation adjustment.

### Recommendation No. 3

The ANAO *recommended* that the ATO instructions accompanying return forms clearly explain the circumstances when government industry assistance is assessable and the options available to taxpayers in disclosing this income.

The ATO agreed the instructions accompanying return forms should clearly explain when government industry assistance is assessable, and that it would take steps to implement this part of the recommendation for 1995-96 income year. However, the ATO considered that the issue of how AGIA income should be disclosed was best addressed following completion of the risk assessment.

### ATO implementation of the recommendation

**2.21** The ANAO found that, although tax return form instructions give examples of AGIP that may be assessable income, the ATO does not clearly explain in the instructions when this income is assessable. For example, ATO Taxation Determination 97/25 advises taxpayers, in relation to the DFR, that the rebate will be assessable income in the hands of the recipient if it is paid as a consequence of the recipient's income producing activities. However, the instructions accompanying return forms do not specify when government industry payments in general are considered to be assessable income in the hands of recipients.

**2.22** A potential consequence of the ATO not identifying when government industry payments are assessable is that taxpayers may not declare industry payments that are assessable. Alternatively, a taxpayer may declare government industry payments received which are not assessable income. Either scenario would result in the ATO determining an incorrect amount of tax payable.

## Education

**2.23** Under the self assessment framework the ATO has a responsibility to meet the tax information needs of taxpayers.<sup>7</sup> The 1996 Audit report focused on two highly related aspects of the ATO's education activities:

- ATO publications; and
- leveraged service techniques.

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<sup>7</sup> Review of Taxpack, Directions for the Future, Australian Taxation Office, December 1994, p. (iii).

## Findings of the 1996 Audit Report

The ANAO found that existing references to taxpayer obligations were not comprehensive and were not targeted at AGIA recipients. The ATO had not sought the assistance of other government agencies to include information on tax obligations as part of industry assistance educational material and payment notifications. It was suggested that an education campaign targeted at relevant taxpayer groups would be timely and would assist taxpayers in understanding their liabilities in this area.

## Recommendation No. 4

The ANAO *recommended* that the ATO review its supplementary publications (for example the Primary Production Worksheet) to clarify the circumstances when government industry assistance is assessable and the way in which the income is to be disclosed.

The ATO agreed with this recommendation.

## ATO implementation of the recommendation

**2.24** The ANAO found that the ATO has provided clarification of the assessability of the DFR in Tax Determination 97/25 (replacing Tax Determination 95/16) as discussed in paragraph 2.21 above. However, the DFR is only one type of government industry payment. Consequently taxpayers may still be unsure as to the assessability of other types of government industry payments. This may result in taxpayers incorrectly declaring government industry payments resulting in the ATO incorrectly determining the amount of tax payable on this income.

**2.25** The 1996 Audit Report also highlighted that, although the issuing of a tax determination had clarified significantly the assessability of DFR (then Tax Determination 95/16), the ATO needed to expand upon this work by ensuring the relevant taxpayers were aware of the determination and its implications. The ANAO found no evidence that the ATO had undertaken this work, although the ATO has identified, as a possible further initiative, conducting an education campaign centred on DFRS Tax Determination 97/25.

## Recommendation No. 3

**2.26.** The ANAO recommends that the ATO reviews its instructions accompanying return forms, and its supplementary publications, to assist taxpayers in correctly declaring AGIP by explaining when, and in what circumstances, government industry payments are assessable income in the hands of recipients.

*ATO response*

**2.27** The ATO agrees with this recommendation. It will be progressed as part of the ATO's ongoing review of the design of tax returns, accompanying instructions and supplementary publications. For some types of government industry payments it may prove necessary to also refer taxpayers to more detailed information provided in supplementary ATO publications (including income tax rulings) and in the publications of the payer government departments. This is likely to be the case for those types of payments received by relatively few taxpayers.

**Leveraged service techniques**

**2.28** Leveraged service techniques involve using a third party's resources to assist in meeting one's own goals. The ATO already uses this technique with third parties such as tax agents to advise taxpayers of their obligations. Financial institutions and some Commonwealth welfare departments also currently provide tax information in conjunction with their payments.

**Recommendation No. 5**

The ANAO *recommended* the ATO review its use of other government publications and forms (for example promotional material and application forms for rebates) as leveraged education tools in relation to AGIA.

The ATO agreed with this recommendation.

**ATO implementation of the recommendation**

**2.29** The ANAO found that the ATO had not formally approached other government departments and agencies (with the exception of the ACS as discussed below) to seek their cooperation by including advice to taxpayers in their relevant publications as to when government industry assistance is assessable income. The ATO advised that it had given priority to undertaking a risk assessment prior to implementing this recommendation.

**Recommendation No. 4**

**2.30** The ANAO recommends that the ATO improves its use of other government publications and forms (for example, promotional material and application forms for AGIP) as leveraged education tools in relation to AGIP.

*ATO response*

**2.31** The ATO agrees with this recommendation. It will be progressed as part of the ATO's ongoing review of the design of tax returns, accompanying instructions, and supplementary publications. The

cooperation of payer government departments will be sought, as part of the ATO's response to Recommendation 2.

### Recommendation No. 6

The ANAO *recommended* the ATO request the ACS to include advice on the assessability of DFRs in ACS information brochures and forms.

The ATO agreed with this recommendation.

### ATO implementation of the recommendation

**2.32** The ANAO examined ACS information brochures and forms provided to DFR applicants. The ANAO found that a number of ACS brochures and forms now include appropriate advice on the assessability of DFRs.

## Enforcement activities

**2.33** Enforcement activities carried out by the ATO not only act as a deterrent for those taxpayers seeking to avoid their taxation obligations but also provide assurance to the wider community that the taxation system is working equitably. During the follow-up audit the ANAO concentrated on the following two areas of enforcement examined in the 1996 Audit Report:

- data matching; and
- ATO audits.

### Findings of the 1996 Audit Report

The ANAO found that although the ATO had expanded its income matching activities, it had not taken advantage of existing AGIA related data held by other agencies.

The ANAO found the scarce use of compatible unique identifiers (eg Tax File Number [TFN]) by agencies and incompatible data specifications and quality between agencies may constrain the effectiveness of any such data matching exercise. It was recognised that data matching is a sensitive issue involving important privacy considerations. However, it can offer considerable benefits in terms of increased compliance, additional revenue and lower administrative costs.

The ATO had not reviewed the benefits associated with extending the use of the TFN, under the existing legislation, to the DFRS nor sought the assistance of the ACS to develop more congruent data specifications and quality. The ANAO also found that owing to the unavailability of the ACS data to tax auditors (as a result of differences in the interpretation of the Memorandum of Understanding [MOU] between the two agencies), tax audit coverage of DFR income was minimal.

## Data matching

**2.34** Comparing ATO records with the records of external sources can be an economical and effective way of enhancing compliance. By undertaking data matching the ATO is provided with an insight into the accuracy and quality of its own data as well as highlighting any anomalies that may require further investigation through other enforcement tools such as audit. Data matching can also be useful for targeting the education needs of taxpayers by highlighting particular groups or sections of the community that are not complying with their taxation obligations. Although data matching is a sensitive issue involving important privacy considerations, these considerations can be adequately catered for with due care. Agencies also need to have due regard to legislation relevant to programs which they administer.

### Recommendation No. 7

The ANAO *recommended* the ATO review the framework for data exchange with government agencies responsible for industry assistance programs, in particular the ACS. The ANAO considered this review should consider the limitations the existing framework may impose on data exchange and identify opportunities to improve data matching to assist education and enforcement.

The ATO agreed with this recommendation noting that due regard would have to be paid to the purposes of existing legislation and guidelines concerning the matching of taxpayer data across and within agencies.

## ATO implementation of the recommendation

**2.35** Since the previous report the ATO has progressed along the following three avenues to address this recommendation:

- developing a new ATO/ACS Memorandum of Understanding (MOU) for the exchange of data;
- assisting Standards Australia in the development of a consistent Australia wide standard for the exchange of client information; and
- investigating the use of a unique identifier for data matching purposes.

## Tax/Customs Memorandum of Understanding

**2.36** The new MOU designed to facilitate better administration of sales tax and formalise relationship details between the two agencies, took effect in June 1997. The MOU outlines the ATO's and ACS' formal agreement to:

*'... cooperate fully in planning for and facilitating the sharing of information and coordinating activities where appropriate, within the confines of legislation'.*

**2.37** To ensure issues identified under the MOU were effectively acted upon, several milestones (to be completed in the 1997-98 financial year) were developed by the joint ATO/ACS Joint Liaison Committee. While the majority of MOU milestones focus on sales tax related activities, the Joint Liaison Committee identified the issue of data exchange as an important issue, and as such, identified it as a milestone to be achieved within the terms of the MOU. As part of a risk management project (see paragraphs 2.1 to 2.13 of this report) there was a transfer of DFRS data from the ACS to the ATO. Notwithstanding this, the ACS has advised the ANAO that its ability to provide information to the ATO, however desirable that might be, is limited by very strict provisions of the *Customs Administration Act 1985*. Specifically, the requirement under section 16 of the *Customs Administration Act 1985* that ACS information can only be provided personally to the principal officer of a receiving agency significantly limits the ACS's ability to routinely transfer information by bulk electronic means.

**2.38** The ACS has also advised that section 16 of the *Customs Administration Act 1985* has been redrafted as part of the National Drug Strategy, in particular to remove the requirement that disclosure of Customs information must be made to the principal officer of Commonwealth agencies and to permit the bulk transfer of information. The ACS and the ATO are currently awaiting Parliament's consideration of an amending Bill. Subject to the passage of the Bill, it is intended that the Joint Liaison Committee will draft exchange of information protocols.

### **Client information exchange**

**2.39** Without a unique identifier such as a TFN (see paragraphs 2.49 to 2.51 of this report), the ATO must rely on the compatibility of other agencies data with their own to effectively match data. The benefits to the ATO of having compatible data with other agencies include:

- costs for matching taxpayer data with external agency data are reduced;
- increased potential for the reduction of inaccurate taxpayer information to be collected and maintained;
- reduced risk of taxpayers being incorrectly selected or targeted through poorly matched data records;
- better protection of the individual's privacy through more accurate data matching;
- increased effectiveness of internal data matching activities;
- reduction of costs for the identification and validation (matching) of taxpayers; and

- added confidence in the accuracy of existing data when used for law enforcement and collection purposes.

**2.40** The collection, handling and use by Commonwealth agencies of information about individuals is regulated by the *Privacy Act 1988*. This Act gives the Privacy Commissioner special responsibilities for safeguarding privacy. Any data matching between the ACS and the ATO would have to take place within this framework. Likewise, if data matching were to include the use of Tax File Numbers, the ATO would need to adhere to the provisions of the *Data Matching Program (Assistance and Tax) Act 1990* and the *Tax Administration Act (1953)*. We are mindful, therefore, of the need for the ACS and the ATO to ensure that they comply with the arrangements established by Parliament and the Government for safeguarding privacy.

**2.41** Owing to the incompatibility of ACS and ATO DFRS data, the ANAO made the following recommendation in its 1996 report:

#### **Recommendation No. 9**

The ANAO *recommended* that the ATO request the assistance of government agencies responsible for administering industry assistance programs, in particular the ACS, which are able to provide information to develop more compatible data specifications.

The ATO agreed with this recommendation. The ATO advised that it was already a member of an interdepartmental committee which had commenced work towards developing an Australian standard for client identification. The ATO anticipated redesigning its stationery (including tax return forms) and databases once the new standard was introduced. The ATO advised that not all agencies responsible for administering industry assistance programs were represented on the interdepartmental committee. The ATO would therefore alert such agencies to the work of this committee and had already advised the ACS in this regard.

#### **ATO implementation of the recommendation**

**2.42** The ANAO found that the ATO had not approached agencies administering AGIP (other than the ACS) to develop more compatible data specifications. However, the ATO has been an active participant in a Standards Australia work-group to develop an Australian standard for client information specifications and data exchange.

**2.43** Standards Australia has established the Client Data Standards Work-Group (CDSWG) with the ATO. This work-group was initiated to investigate the implementation of a national standard to facilitate the matching, validation and information exchange of data. By providing a standard which stipulates the types and format of client data, the process

of matching should become easier and more cost effective. To ensure all relevant organisations are represented, public, private and academic representatives comprise the work-group.

**2.44** National standards can be complex documents which may require considerable consultation. A draft document has recently been issued for public comment. The ANAO suggests that interim data exchange protocols be agreed with agencies administering AGIP pending the issue of the finalised standard.

### **Data cleansing and reformatting software**

**2.45** Although data compatibility between agencies can be improved, the ATO may not be able to implement data protocols that are congruent with every agency administering an AGIP. Therefore, the use of data cleansing and reformatting software to create compatible data, (for example even a relatively minor matter such as changing the word 'Street' to 'St.'), would significantly enhance the ATO's ability to match data with incompatible data from other agencies. The 1996 Audit Report made the following recommendation in relation to data cleansing software:

#### **Recommendation No. 10**

The ANAO *recommended* that the ATO further develop its use of data cleansing and reformatting software to overcome externally sourced data compatibility problems.

The ATO agreed with this recommendation. The ATO advised that they had already commenced work in this area and were evaluating commercially available software products. The initial focus of their evaluation was on address data, identity data (names and date of birth) and TFNs, for both ATO and externally sourced data. In addition, the ATO was moving towards standardising data formats for the address and identity information, again both for ATO and externally sourced data.

### **ATO implementation of the recommendation**

**2.46** The ANAO found that the ATO utilises the NADIS suite of software to cleanse and re-format data held within the ATO. The ATO advised it is planning to upgrade this software in the near future. However, in relation to external data received for data matching purposes, the ATO has found it more effective to develop its own data cleansing and re-formatting software to overcome externally sourced data compatibility problems rather than using the NADIS suite of software. The ANAO considers that, as the implementation of the draft standard for the matching, validation and information exchange of data may not occur for some time, the ATO should ensure that its data cleansing software is effective.

## Recommendation No. 5

**2.47** The ANAO recommends that, in the absence of compatible data exchange protocols, the ATO continues to develop its use of data cleansing and re-formatting software to address externally sourced data compatibility problems.

### *ATO response*

**2.48** The ATO agrees with this recommendation. The ATO recognises the value of externally sourced information, and that its effective use depends on the ability to cleanse and reformat the data.

### Compatible unique identifier

#### Recommendation No. 8

The ANAO *recommended* the ATO, as part of any subsequent compliance research, and in conjunction with the ACS, investigate the feasibility of implementing a compatible unique identifier (eg TFN) in the DFRS.

The ATO was generally supportive of this recommendation noting the findings from the risk assessment identified in Recommendation No. 1 should act as an important guide as to whether this recommendation warranted being pursued. The ATO also noted that if this recommendation were to be pursued, due regard would have to be paid to the fact that any such extension of the use of TFN was a matter for the Government to determine.

### ATO implementation of the recommendation

**2.49** The ANAO recognises the implementation of this recommendation was dependent on the outcome of the risk assessment project. During the ATO's risk assessment project, the ATO became aware that it would be possible to match DFR paid to companies by the ACS with amounts declared in company tax returns by linking the Australian Company Number (ACN) details held by both agencies to TFN details held by the ATO. This is significant in the case of DFRs as the ATO estimates that companies receive approximately 66 per cent of all DFRs paid, amounting to \$775 million in 1994-95.

**2.50** The risk assessment project also found that DFRS rebate payments to unincorporated businesses (approximately 90% of business rebate recipients) totalled approximately \$405 million in 1994-95. The ATO considers that, in the absence of a unique identifier for unincorporated businesses, the ATO cannot use the ACS DFRS database directly or cost-effectively to identify non-lodgers.

**2.51** The ATO has identified as a possible future initiative, the extension of the Reportable Payments System (RPS) to include AGIP payments,

commencing with rebates paid under the DFRS. DFRS rebate recipients would then be required to provide the ACS with their TFN in order to avoid taxation of the rebate 'at source'. The TFN and related DFRS payment information recorded by the ACS could then be provided to the ATO for matching with income declared in the tax returns of DFR recipients. The ANAO notes that the ATO has not yet raised the possible extension of the RPS with the ACS. The ANAO considers further investigation by the ATO of this initiative would be worthwhile as the inclusion of AGIP within the RPS could enhance the ATO's ability to conduct enforcement activities.

## ATO audits

### Recommendation No. 11

The ANAO *recommended* the ATO, as part of any subsequent compliance research, develop and implement an effective audit strategy to ensure the disclosure of assessable DFR and other forms of AGIA.

The ATO considered that the feasibility and desirability of implementing such a strategy was best addressed once the results of any compliance research were available. The ATO also noted results of its initiatives associated with the ANAO's data matching recommendations were also relevant here.

## ATO implementation of the recommendation

**2.52** The ANAO recognises the implementation of this recommendation was also dependent on the outcome of the risk assessment project. The ANAO found that the ATO has taken a number of steps towards achieving this recommendation including:

- the introduction of the AGIP business label which will encourage taxpayer declaration of this income and facilitate future ATO audits of AGIP income received by taxpayers through data matching; and
- the identification of ACNs as a tool for matching some DFRS data held by the ATO and the ACS (discussed in paragraph 2.49).

## Recommendation No. 6

**2.53** The ANAO recommends that the ATO undertake further compliance research in relation to AGIP and, based on the results obtained, develop and implement appropriate compliance improvement initiatives to enhance the disclosure of AGIP in the income tax returns of recipients.

*ATO response*

**2.54** The ATO will consider implementation of this recommendation as part of its risk identification and assessment processes in 1998-99. The nature and scale of any implementation will depend on competing priorities and available resources.

---

Canberra ACT  
12 August 1998

A handwritten signature in black ink, appearing to read 'P.J. Barrett', is positioned above the printed name and title.

P.J. Barrett  
Auditor-General



# Appendices



## Appendix 1

ATO Diesel Fuel Rebate Scheme (DFRS) Survey –  
Questionnaire

# Diesel Fuel Rebate Scheme (DFRS) Survey

## Instructions

If you are having any difficulty in filling out the questionnaire, please feel free to call David Harwood on (06) 216 2000.

1. *Please complete carefully the attached questionnaire.*
2. *When filling out this questionnaire please PRINT using capital letters.*
3. *Please return in the Reply Paid addressed envelope by* .

## Background

The Australian National Audit Office (ANAO) has recently completed a performance audit into Assessable Government Industry Assistance (AGIA). A report on the audit was presented to Parliament early in 1998. The audit focussed on the Diesel Fuel Rebate Scheme (DFRS) and the extent to which the rebate is reported as assessable income in tax returns.

**The rebate is considered assessable income in the hands of recipients if it is received in, or in relation to, the carrying on of a business.** Due to insufficient data, the ANAO was not able to establish the extent to which rebates are reported. However, the ANAO concluded that there was a significant risk to the taxation revenue which should be addressed by the Australian Taxation Office (ATO).

## Purpose

The ATO is undertaking a risk assessment project to address the concerns of the ANAO. A key element of this project is this survey questionnaire. It is being sent to a limited number of DFRS rebate recipients.

All recipients included in the survey have been identified as receiving a DFRS rebate during the 1994-95 income tax year.

The ATO has also involved key business and professional organisations by inviting them to comment on the design of the questionnaire. This consultation was undertaken in order to ensure that the questionnaire reflected as closely as possible the commercial accounting practices of rebate recipients.

As part of this project, the ATO may need to seek further information from a limited number of questionnaire recipients.

**Please Note:** The ATO's usual practice is to send requests for information to the "current postal address" for taxation purposes. However, in order to ensure an adequate and statistically representative coverage of *all* DFRS recipients, this questionnaire will be mailed directly to the "DFRS rebate recipient postal address".

**THANK YOU FOR YOUR CO-OPERATION**

## Appendix 1 (cont)



# Diesel Fuel Rebate Scheme (DFRS) Survey — Questionnaire

### Privacy

If you are an individual, you should note that the *Privacy Act 1988* requires that the Australian Taxation Office (ATO) advise you that it is not an offence not to quote your Tax File Number (TFN). However, your TFN helps the ATO to correctly identify your tax records.

The ATO is authorised by the *Income Tax Assessment Act 1936* to ask for information. We need this information to help administer the tax laws. We may give some of this information to other government agencies authorised by law to receive it, including the Australian Customs Service and the Department of Social Security.

Please provide the following information or tick ☒ the appropriate box(es)

#### 1. Details of DFRS rebate recipient receiving this questionnaire:

#### 2. Are the above DFRS rebate recipient details correct? (If not please provide new details below):

Name			
Address			
Telephone Number		Facsimile Number	
Email			

#### 3. Please provide DFRS rebate recipient Tax File Number (TFN):

--	--	--	--	--	--	--	--	--	--

If more than one TFN please attach details

#### 4. Details of person filling out questionnaire:

Name			
Address			
Telephone Number		Facsimile Number	
Email			

#### 5. In what capacity are you responding on behalf of the above DFRS rebate recipient?

<input type="checkbox"/> Sole Owner	<input type="checkbox"/> Partner	<input type="checkbox"/> Trustee	<input type="checkbox"/> Public Officer	<input type="checkbox"/> Tax Agent
<input type="checkbox"/> Other (e.g. Accountant, Secretary, Director, Manager of Joint Venture, Authorised Person/Agent/Applicant etc., <i>please specify</i> ):				

#### 6. Before receiving this Questionnaire, were you aware that the DFRS rebate is assessable income in the hands of recipients if it is received in, or in relation to, the carrying on of a business?

<input type="checkbox"/> Yes	<input type="checkbox"/> No
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