

The Auditor-General
Audit Report No.46 1999–2000
Performance Audit

High Wealth Individuals Taskforce

Australian Taxation Office

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ISSN 1036-7632
ISBN 0 642 44302 5

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Canberra ACT
13 June 2000

Dear Madam President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in the Australian Taxation Office in accordance with the authority contained in the *Auditor-General Act 1997*. I present this report of this audit, and the accompanying brochure, to the Parliament. The report is titled *High Wealth Individuals Taskforce*.

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

AUDITING FOR AUSTRALIA

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Contents

Abbreviations/Glossary	6
Summary and Recommendations	
Summary	9
Background	9
Audit approach	10
Overall conclusion	10
Key Findings	11
Recommendations	13
Audit Findings and Conclusions	
1. Introduction	17
Background to the development and activities of the HWI Taskforce	17
Risk management	22
Related reports	22
Audit objectives, criteria and method	23
Structure of the report	23
Acknowledgments	24
2. Corporate Governance	25
Structure of the taskforce	25
Taskforce resourcing	26
Planning	26
Management reporting	28
Compliance management	29
Internal evaluation	42
Coordination of ATO effort	45
3. Taskforce Outcomes	47
Revenue	47
Taskforce involvement in addressing tax minimisation techniques	56
Taskforce reporting of outcomes	59
Future HWI work	60
Index	63
Series Titles	65
Better Practice Guides	69

Abbreviations/Glossary

AIS	ATO Integrated System
ANAO	Australian National Audit Office
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
DOFA	Department of Finance and Administration
HOTSA	Health Of The System Assessment
HWI	High Wealth Individual
LB&I	Large Business and International business line
MoU	Memorandum of Understanding
RAB	Revenue Analysis Branch (ATO)
R&D	Research and Development
TCN	Tax Counsel Network
TFNs	Tax File Numbers

Summary and Recommendations

Summary

Background

1. During 1995–96, the Australian Taxation Office (ATO) raised concerns about the income tax compliance behaviour exhibited by some wealthy individuals because some of these taxpayers paid little or no personal income tax. Based on analysis of a sample of taxpayers and their related entities, a figure of \$800 million per year was derived by the ATO as an order of magnitude estimate of revenue potentially at risk.

2. In May 1996, the Commissioner of Taxation announced a comprehensive compliance program to expand the ATO's understanding of tax planning techniques used by what came to be titled the High Wealth Individuals (HWI)¹ taxpayer group, and the resulting compliance risks. An HWI Taskforce was set up with the objectives of acting on the tax planning techniques already identified; gaining an expanded and comprehensive understanding of the techniques employed; and continuing to identify, monitor and address emerging techniques. Many of the tax planning arrangements in place at the time were legal.

3. In the 1996–97 Budget, the Government allocated additional funds to the ATO of \$9.7 million in 1996–97 and \$9.5 million in 1997–98 to enhance the ATO's investigations into HWIs' compliance with tax laws. At that time it was estimated that improvements in taxation compliance by HWIs would generate additional revenue in the order of \$100 million in 1997–98. In the 1998–99 Budget, the Government extended funding for a further two years, allocating \$9.5 million in each of 1998–99 and 1999–2000. The Government required additional revenue from taskforce activities of \$100 million in each of these two years.

4. The Government's decisions to provide additional resources to the ATO required the HWI taskforce to accomplish the following two outcomes:

- undertake on-going investigation and management of the payment of income tax by high wealth individuals (to yield an estimated \$100 million in additional revenue in each of 1997–98, 1998–99 and 1999–2000); and

¹ The ATO defines a HWI as an individual who owns or controls net wealth of \$30 million or more.

- develop progressively administrative responses and, in association with the Treasury, legislative proposals to address undesirable tax minimisation practices as they are identified.

5. During the course of the audit, the Senate Economics References Committee completed its inquiry into the operation of the ATO. Part of its investigation included reviewing aspects of the performance of the High Wealth Individuals' program. The ANAO has considered the report of the Committee² and has taken account of the Committee's findings and views where they are relevant to the subject matter of this audit. In particular, as the Senate Committee requested, the ANAO has examined the HWI taskforce's approach to handling tax in dispute.

Audit approach

6. The objective of the audit was to examine and report on the management and operations of the ATO's HWI taskforce. In doing so, the audit reviewed the ATO's own evaluation³ of the taskforce, and assessed whether, and to what extent, the taskforce delivered the outcomes specified by the Government.

7. The focus of the audit was on providing assurance to the Parliament on the work that is being undertaken by a high profile taskforce. To gain this assurance, the ANAO examined the management structures, reporting arrangements, operational methods, and performance monitoring and review practices of the taskforce.

Overall conclusion

8. The management and operations of the taskforce are considered effective. The ANAO also concluded that the taskforce:

- manages the investigation of the tax affairs of HWIs in accordance with the ATO's risk management principles;
- is achieving the revenue targets set by government;
- has contributed to the development of administrative and legislative proposals to address undesirable tax minimisation practices; and
- could improve its reporting of taskforce outcomes.

² Senate Economics References Committee, *Operation of the Australian Taxation Office*, 9 March 2000.

³ In 1998 the ATO commissioned an evaluation review to assess the effectiveness of the taskforce in its first two years and to recommend any improvements to the on-going management of HWI compliance, particularly strategies to assess and treat risks to compliance.

Key Findings

Corporate governance

9. The ANAO considers that the taskforce's Compliance Management Strategy is an effective response to the challenges of dealing with the tax affairs of the HWI taxpayer population. As part of the strategy, audit priorities are determined as a result of an effective risk assessment process. The work of the taskforce has resulted, not surprisingly, in additional compliance costs for some HWI taxpayers.

10. The ANAO has found that the taskforce conducts settlement processes for handling tax in dispute in accordance with the ATO's *Code of Settlement Practice*. Settlement processes have been conducted with a view both to protection of the revenue outcomes and to the on-going maintenance of fairness to the HWI taxpayers concerned.

11. The ANAO has concluded that appropriate administrative arrangements and information systems are now in place to support coordination of the work of the taskforce with other relevant areas of the ATO.

12. The ANAO considers that the ATO's internal evaluation of the operations of the taskforce provided a comprehensive review of key management issues and that its recommendations were practical and consistent with the evaluation findings.

Taskforce outcomes

13. From the ATO's initial investigations of the HWI taxpayer population, a figure of \$800 million per year had been derived as an order of magnitude estimate for revenue potentially at risk through HWIs application of tax planning practices. The \$800 million does not represent additional revenue that could be gained from HWI taxpayers solely through application of compliance action by the ATO. Rather, it was seen by the ATO as potential revenue at risk of being lost if no legislative action was taken against the range of tax planning and minimisation practices employed by some HWIs. The major component of increased revenue would come only from the down-stream impact of effective and timely legislative changes to remedy deficiencies in the law. Nevertheless, the taskforce was expected to increase tax revenue during its operation through improvement in compliance by HWIs.

14. The taskforce has achieved its revenue targets for 1997–98 and 1998–99. Collections in 1996–97 were included in accounting for the 1997–98 target as they were achieved earlier than anticipated. Revenue figures for the 1999–2000 year of collection cannot be finalised until after the conclusion of the financial year. The targets were achieved by a combination of direct revenue from audit and assessment, and indirect revenue from compliance improvement in the HWI population. The ANAO confirmed that the taskforce’s direct revenue results represent actual cash received and do not include tax amounts in dispute nor amounts that are subject to negotiated payment arrangements extending over a period of time.

15. The ANAO confirmed that advice provided by the taskforce to Government has resulted in initiatives, including legislation, to address a number of tax planning techniques in use by HWIs. The taskforce contributed to the work of the ATO, the Treasury and the Review of Business Taxation in their recommendations to Government on legislative changes.

16. The ANAO considers that the consistency of the taskforce’s reporting arrangements could be improved. In recognition of the importance of encouraging compliance by the taxpayer community, the ATO should report publicly on the taskforce’s achievements each year. This could be seen as a further means of enhancing the confidence of the Australian taxpaying community in the ATO’s compliance management activities.

Recommendations

17. The ANAO has made three recommendations aimed at improving the public reporting of the outcomes of the HWI taskforce’s work and continuance of its effective operations within the context of a sound risk management framework. The ATO has agreed to all of the recommendations.

Recommendations

Set out below are the ANAO's recommendations aimed at improving the public reporting of the outcomes of the HWI taskforce's work and continuance of its effective operations within the context of a sound risk management framework. Report paragraph references and ATO responses to the ANAO's recommendations are also included.

Recommendation No.1
Para. 3.7

The ANAO recommends that the ATO report the HWI taskforce's revenue outcomes on a consistent and standardised basis so that the taskforce's level of achievement is more readily discernible from year to year.

ATO Response: Agree

Recommendation No.2
Para. 3.57

The ANAO recommends that the ATO report publicly each year on the on-going achievements of the HWI taskforce in terms of:

- the revenue, both direct and indirect, that has been gained through audit and other activities of the taskforce; and
- the initiatives it has taken to address undesirable tax minimisation practices.

ATO Response: Agree

Recommendation No.3
Para. 3.68

The ANAO recommends that, subject to appropriate risk assessment, the ATO consider retention of the capability for dealing with the complexity of tax matters characteristic of high wealth individuals and their associated entities.

ATO Response: Agree

Audit Findings and Conclusions

1. Introduction

This Chapter describes the background to the establishment of the High Wealth Individuals' taskforce and relevant aspects of the Australian Taxation Office environment. It also sets out the audit objectives, criteria and approach for the audit and outlines the structure of this report.

Background to the development and activities of the HWI Taskforce

1.1 During 1995–96, the Australian Taxation Office (ATO), through its Health of the System Assessment (HOTSA) process⁴, raised concerns about the income tax compliance behaviour exhibited by some wealthy individuals because many of these taxpayers paid little or no personal income tax.

1.2 Examination by the ATO in 1996 of the income tax affairs of a sample of this group of taxpayers, that is, those with an estimated net wealth of over \$30 million and who had returned taxable income of less than \$20 000⁵, showed that there was a limited number of such taxpayers in Australia, and that characteristics of these taxpayers included the following:

- typically they have complex business and personal financial arrangements and a number operate businesses world-wide;
- they usually have sophisticated advice available to them on the application of the tax laws;
- some employ arrangements that allow them to accumulate significant personal wealth and maintain apparently expensive lifestyles while paying very little if any personal income tax; and
- some own, control, or are associated with, a number of entities such as companies or trusts that also pay little or no tax.

⁴ The ATO's HOTSA process is discussed further at paragraph 1.19.

⁵ Reported in the Statement by the Treasurer *Meeting our Commitments* 20 August 1996.

1.3 These characteristics of what came to be titled the High Wealth Individual (HWI)⁶ taxpayer group were known to the ATO from available sources. However, the ATO recognised that it did not have a complete understanding of how the various elements of the HWI population handled their business and taxation affairs. The ATO acknowledged also that, while the personal circumstances of many HWIs led to their paying significant levels of tax, others had used the legitimate concessions allowed in tax laws to reduce their taxation responsibilities to relatively low levels. However, yet another group had adopted aggressive tax planning techniques that appeared to test the interpretation limits of the existing taxation laws. To impose a legalistic interpretation of tax laws on the HWI population in general could be seen as a means of raising revenue without taking account of the circumstances of the HWI group as a whole and of individuals within that group. The ATO determined, therefore, that further information was required on the particular arrangements in use within the HWI segment so that compliance risks could be addressed with the benefit of better knowledge.

1.4 Initial research by the ATO showed that a range of complex tax planning and minimisation practices had been used by some HWIs including:

- distributions and loans from trusts;
- creation and utilisation of losses;
- intra-group arrangements, particularly debt forgiveness;
- characterisation of profits on sale of properties by developers;
- interest deductions relating to property development;
- offshore transactions and arrangements;
- Research and Development (R&D) deductions; and
- alienation of personal services income.

1.5 In May 1996, the Commissioner of Taxation announced that the ATO was developing a comprehensive compliance program to:

- act on the unacceptable tax planning and minimisation techniques already identified in the HWI segment of the taxpayer population;
- gain an expanded and comprehensive understanding of the tax planning and minimisation practices employed by HWIs; and
- continually identify, monitor and address emerging minimisation techniques.

⁶ The ATO defines an HWI as an individual who owns or controls net wealth of \$30 million or more.

1.6 The Commissioner noted that the package of measures to be undertaken would include, as appropriate:

- information collection and analysis;
- release of rulings clarifying the ATO's view of how the law applied to particular arrangements;
- litigation to test the law;
- audit and prosecution activity; and
- recommendations to the Government on appropriate legislative responses.

1.7 In order to progress these measures, the ATO reallocated some staff and funding resources, and established the High Wealth Individuals Taskforce.

1.8 When the present Government came to office in 1996, it was advised by the Treasury and the ATO of the potential impact on revenue of continuation of the tax planning and minimisation practices utilised by some HWI taxpayers. A figure of \$800 million per year, as had been disclosed by the previous Government, for revenue potentially at risk through HWIs' application of tax planning practices, had been derived as an order of magnitude estimate arising from the ATO's initial investigation of the HWI taxpayer population, mentioned at paragraph 1.2.

1.9 Advice to the incoming Government was that \$800 million did not represent additional revenue that could be gained from HWI taxpayers solely through application of compliance action by the ATO. The Treasury and the ATO advised the Government that the figure of \$800 million should be seen as revenue potentially at risk of being lost if no legislative action was taken against the range of tax planning and minimisation practices employed by some HWIs.

1.10 That is, while some of the estimated revenue at risk would be expected to be recoverable through administrative action that the ATO could put into effect to improve compliance with the existing law, the major component of increased revenue would come only from the downstream impact of effective and timely legislative changes to remedy deficiencies in the law. This is because it was argued by HWIs and their advisers that many of the tax planning arrangements in place at the time (1996), such as the use by HWIs of links between trusts and private companies to manage their tax affairs, were legal. HWI taxpayers were seeking to arrange their affairs in order to minimise their taxation within the provisions of the tax laws, as they were entitled to do.

1.11 The allocation of additional resources to the taskforce did not require the taskforce to recover the \$800 million revenue at risk figure mentioned earlier. In its deliberations on the matter of additional resources, the Government accepted that how much revenue might be obtained, and when, depended upon a number of factors, including the comprehensiveness of the ATO's understanding of the practices involved and of associated tax law deficiencies, its ability to address these issues, as well as the timing and effectiveness of any legislative measures.

1.12 In the 1996–97 Budget papers, the Government reinforced its acceptance of the foregoing view, with the Treasurer indicating that:

The revenue at risk from aggressive tax planning and minimisation arrangements used by some high wealth individuals, has been estimated at \$800 million a year. Treasury and the ATO caution that this estimate is subject to uncertainties about wealth data, remedial measures, utilisation of losses and behavioural responses by affected taxpayers. This figure should be seen as an order of magnitude estimate of the 'revenue potentially at risk' rather than as the 'sum of gains from particular measures'.

Taskforce investigation will first identify the nature of the problem and mechanisms used, then design counter measures expected to generate revenue beyond 1997–98.⁷

1.13 In the 1996–97 Budget, the Government allocated additional funds to the ATO (\$9.7 million in 1996–97 and \$9.5 million in 1997–98) to improve the compliance of HWIs with the tax laws. This additional funding augmented that already made available to establish the taskforce through re-allocation of ATO resources. In announcing the additional funding, the Treasurer noted that:

Enhanced investigation activity and analysis will allow a greater understanding of the complex arrangements used by some high wealth individuals to minimise tax, and to progressively develop administrative and legislative proposals to deal with these arrangements and others that may be put in place in the future.⁸

⁷ Treasurer, op. cit.

⁸ Treasurer, *Budget Speech 1996–97*, 20 August 1996.

1.14 In providing additional funding to the taskforce, the Government expected that improvements in compliance by HWIs as a result of the activities of the taskforce, both voluntarily and through enforcement of existing law, would generate revenue in the order of \$100 million⁹ in 1997–98.

1.15 In the 1998–99 Budget, the Government extended funding for the taskforce for a further two years—allocating \$9.5 million in each of 1998–99 and 1999–2000. The ATO expected that revenue generated by improvements in compliance by HWIs through the taskforce’s on-going investigations would generate revenue returns in the order of \$100 million in each of these two years. The taskforce’s performance in raising such revenue is discussed from paragraph 3.3.

1.16 The ANAO is aware that the cost/benefit of the taskforce was discussed¹⁰ during the conduct of the Senate Economics References Committee’s review of the operations of the ATO. That is, the cost of the taskforce offset against the amount of revenue that it was required to collect¹¹ has been compared to the average net cost of revenue collection by all ATO activities.¹²

1.17 The ANAO notes that the additional revenue to be returned by the taskforce on the investment of the Government’s additional funding was expected to be in the ratio of about 10 to one. That is, additional revenue of \$100 million each year was to be achieved for the additional outlay of approximately \$10 million each year. This return ratio and the net cost of collection that the ATO reports each year are not comparable, as the measures are different in kind. This latter figure represents an average based on total revenues and total ATO costs. This is not the same as the cost of undertaking any project from time to time that may result in more than just collecting additional revenue.

⁹ That is, the additional revenue requirement of \$100 million per annum was to be measured as that revenue achieved over and above what HWI individuals and associated entities would have paid without the operations of the HWI taskforce.

¹⁰ Senate Economics References Committee, *Operation of the Australian Taxation Office*, 9 March 2000, p. 65.

¹¹ For the ATO as a whole, the net cost of collecting \$100 was 82 cents in 1998–99. (Source: ATO *Annual Report 1998–99*)

¹² The ATO is the Commonwealth’s principal revenue collection agency. The ATO is responsible for collecting a number of different taxes. In 1998–99, the ATO accounted for total tax revenue of \$135.3 billion.

Risk management

1.18 In carrying out its responsibilities, including in the collection of revenue, the ATO has adopted a sound risk management framework.¹³

1.19 The ATO's HOTSA process forms the basis of a continuing assessment of the risks involved in the collection of tax. In use within all business lines of the ATO, the HOTSA is a key input into the ATO's strategic planning framework. Risk assessments, which are the foundation of the HOTSA, provide the basis for identification of priorities and subsequent resource allocation.

1.20 Risk assessments derived from the HOTSA process are part of the compliance strategy implemented throughout the ATO, including by the HWI taskforce.

Related reports

1.21 On 24 June 1998, the Senate referred to the Senate Economics References Committee the matter of the operation of the ATO¹⁴ with particular reference to:¹⁵

- the equitable treatment of taxpayers;
- the performance of the Large Business and International Division, including, in particular, the High Wealth Individual Project;
- compliance by the ATO with the Client Settlement Guidelines; and
- allegations of infiltration of the ATO by organised crime.

1.22 The ANAO has considered the March 2000 report of the Committee and has taken account of the Committee's findings and views where they are relevant to the subject matter of this audit. Our report contains references to the work of the Committee, where applicable, in Chapter 2.

1.23 In 1998, the ATO commissioned an internal evaluation review of the taskforce to assess the effectiveness of the taskforce in its first two years and to recommend any improvements to the on-going management of HWI compliance, particularly strategies to assess and treat risks to compliance.

¹³ The ANAO has reported on risk management practices within the ATO in two previous reports. Audit Report No.37 1996–97, *Risk Management—Australian Taxation Office* focused on the broad strategic issues relevant to risk management for the ATO as a whole while Audit Report No.19 1997–98, *Risk Management in ATO Small Business Income* focused on the risk management processes of the ATO's then Small Business Income business line.

¹⁴ This inquiry had its origins in the *Sunday* television program screened in mid-1998.

¹⁵ Senate Economics References Committee, op. cit., p. 1.

1.24 The ANAO has had access to the reports arising from this evaluation review. This report comments further on our examination of the findings and action outcomes of the evaluation review in paragraphs 2.76 to 2.88.

Audit objectives, criteria and method

1.25 The objective of the audit was to examine and report on the management and operations of the ATO's HWI taskforce. In doing so, the audit reviewed the ATO's own evaluation of the taskforce and assessed whether, and to what extent, the taskforce delivered the outcomes specified by Government. As noted at paragraph 1.22, the audit took account of the relevant findings regarding the HWI taskforce contained in the report of the Senate Economics References Committee.

1.26 The focus of the audit was on providing assurance to the Parliament on the work that is being undertaken by a high profile element of the ATO. To gain this assurance, the ANAO examined the management structures, reporting arrangements, operational methods, and performance monitoring and review practices of the taskforce. The ANAO noted that the Senate Economics References Committee, in its report on the operations of the ATO, requested that the ANAO examine the taskforce's approach to handling tax in dispute. The ANAO has done this, and reports on this matter in paragraphs 2.69 to 2.75.

1.27 In carrying out this audit, the ANAO:

- conducted audit field work at the taskforce sites located at the ATO's Sydney, Box Hill, Casselden Place, Brisbane and Waymouth offices, as well as in its National Office in Canberra;
- held discussions with officers at various levels within the taskforce and, as necessary, with ATO officers in other business and service lines;
- collected and examined relevant documents; and
- reviewed the taskforce's planning documents and performance data.

1.28 The total cost of the audit was approximately \$157 105. The audit was conducted in accordance with ANAO auditing standards.

Structure of the report

1.29 This first chapter describes the background to the establishment of the taskforce and relevant aspects of the ATO environment.

1.30 Chapter 2 of the report deals with the taskforce's corporate governance framework, and discusses:

- the organisation structure and resource levels of the taskforce and the planning and management reporting procedures that the taskforce has implemented;
- the compliance management system that the taskforce has in place to achieve its required outcomes; and
- the internal ATO evaluation that has been conducted on the operations of the taskforce and the ATO's coordination of activities relevant to the responsibilities of the taskforce.

1.31 Chapter 3 of the report deals with taskforce outcomes and discusses:

- the outcomes that the Government required the taskforce to achieve;
- the ANAO's assessment of the taskforce's performance against those required outcomes; and
- the future for the taskforce.

Acknowledgments

1.32 The ANAO wishes to express its appreciation for the time, effort and expertise contributed by ATO officers during the audit and in the preparation of this report.

2. Corporate Governance

This Chapter focuses on the ANAO's findings concerning the taskforce's corporate governance framework. In particular, it addresses the organisation structure and resource levels of the taskforce, its planning and management reporting procedures and the compliance management system that it has in place to achieve its required outcomes. The Chapter also comments on the internal ATO evaluation that has been conducted on the operations of the taskforce and the ATO's coordination of activities relevant to the responsibilities of the taskforce.

Structure of the taskforce

2.1 The HWI taskforce is formally a 'Topic Segment' within the Large Business and International (LB&I) business line of the ATO. The LB&I business line comprises:

- a number of Industry Segments, for example Mining and Petroleum, Property and Construction, Banking and Finance;
- a number of Topic Segments, for example International, Strategic Intelligence Analysis, Research and Development; and
- infrastructure support such as Business Systems.

2.2 Overall leadership of the taskforce is undertaken by a First Assistant Commissioner. Due to the high profile nature of the responsibilities handled by the taskforce, the First Assistant Commissioner in charge of the taskforce reports to a Steering Committee comprising the Commissioner of Taxation and two Second Commissioners, rather than to the National Program Manager of the LB&I business line.

2.3 The taskforce is divided into two regions—the Northern Region comprises teams located at the ATO's Sydney CBD and Brisbane offices, while the Southern Region comprises teams located at the Box Hill and Casselden Place offices in Melbourne, the Waymouth office in Adelaide and the Northbridge office in Perth. Each region is led by a Regional Director.

2.4 Teams in the Northern and Southern regions undertake both risk assessment and risk analysis as well as audit work, as described in the compliance management section of this report from paragraph 2.21.

2.5 In addition, there are two specialised teams in the taskforce:

- the Research and Analysis Team, which comprises:
 - a team of officers located in Box Hill to coordinate all action for the 'Expanded Returns' process; and
 - a team of officers based in both Sydney and Box Hill to carry out:
 - revenue measurement;
 - taskforce reporting;
 - maintenance of the HWI list;
 - technical coordination; and
 - macro research into HWI issues; and
- the HWI System Support Team located in National Office to provide system support required by taskforce staff using the HWI System.

2.6 The Treasurer's announcement of additional funding for the ATO, referred to at paragraph 1.13, established a number of aims for the taskforce. A summary of the resulting outcomes that the taskforce is required to achieve is provided at paragraph 3.1. The ANAO found that the taskforce's organisation structure supports cost-effective management of processes that contribute to the achievement of the required outcomes.

Taskforce resourcing

2.7 The taskforce operation is a major project within the ATO, with resourcing in 1999–2000 of approximately \$14.85 million to cover salary, administrative and other costs, such as legal expenses, in relation to approximately 130 staff. Of this total expenditure, the additional funding provided by Government specifically for this activity totals \$9.5 million (discussed at paragraph 1.15).

2.8 The specific purpose funding granted to the ATO for the establishment of the taskforce will cease at the end of 1999–2000. Arrangements are underway within the ATO to ensure continuing resourcing of the taskforce into future years. While the actual extent of resourcing to be provided remains to be confirmed, taskforce planning is based on a continuing resource level of around 120 staff and expenditure of \$16.75 million (the increase in funding is required to cover expected increased legal costs).

Planning

2.9 As stated at paragraph 2.1, the taskforce is formally a segment of the LB&I business line. The taskforce operates with a large degree of autonomy, under the leadership of the First Assistant Commissioner who

reports to the HWI Steering Committee. Nevertheless, the taskforce's business planning is carried out within a hierarchy of planning and reporting levels, as required generally of other LB&I business line segments.

2.10 The strategies and performance indicators in the HWI Segment Plan are linked to the ATO's Corporate Plan through the LB&I Level 1 Plan. The taskforce's Plan and associated Segment Overview includes:

- an outline of the taskforce's environment, challenges and directions;
- taskforce resources for three forward years;
- high level strategies for the current year; and
- details of the taskforce's contribution, including required outcomes and performance indicators, towards achievement of components of the LB&I Level 1 plan, in such areas as revenue collection and client focus.

2.11 Within the taskforce, each staff member is required to have in place either a Performance Agreement (Executive Level 2 staff and above) or an Expectation Statement (other taskforce staff) linked to the requirements of the HWI Segment Plan and containing details of expected results, activities required to produce those results, and performance measures against which to assess the level of staff achievement. All taskforce staff are provided also with a personal training plan. Performance agreements/expectation statements are in place for a period of one year. Taskforce staff are subject to an appraisal process at the end of the relevant period.

2.12 The staff interviewed by the ANAO during the course of the audit appeared to understand the activities and projects that the taskforce was required to achieve under the Segment Plan, together with individual requirements, including monitoring and reporting on performance achievements, that had been placed on them through their own performance agreements/expectation statements. Moreover, taskforce staff indicated that they were committed to the success of the taskforce in meeting its required level of performance, and to making an individual contribution towards that success.

2.13 The ANAO considers that taskforce planning is well structured; that it is understood by taskforce staff; and that it contributes to achievement of, and reporting on, the operational outcomes required of the taskforce.

Management reporting

2.14 The ANAO is aware that, at the highest level, the First Assistant Commissioner of the taskforce has provided a number of reports direct to the Treasurer on the progress of the taskforce's activities. These reports have provided an overview of key statistical information, major identified tax planning techniques and compliance issues, suggested areas for policy reform and estimated revenue impacts. The ANAO considers that such reports should contribute substantially to the Government's understanding of issues relevant to tax planning techniques used by HWIs.

2.15 The taskforce also provides an annual update report to the HWI Steering Committee on the activities of the taskforce, its achievements to date and an overview of new and emerging HWI taxation issues identified. The ANAO has examined the latest available such report (August 1999) and considers that the content and coverage of the report satisfies ATO corporate governance reporting requirements.

2.16 In terms of performance management and reporting, the ANAO found that the taskforce regularly monitors progress against performance indicators contained in its Segment Plan.

2.17 Since its creation in 1996, the taskforce has been required, as a Topic Segment within the LB&I business line, to report to LB&I on its performance in a variety of formats. For example, the taskforce reports as necessary on its performance against Taxpayers' Charter¹⁶ standards.

2.18 Input from taskforce staff at the team and regional levels contributes to the content of taskforce reports. The ANAO has examined a sample of monthly work reports dealing with individual, team and regional work outputs. Each of these reports identifies the particular HWI that the individual, team or region has examined, and the number of hours that have been spent on work outputs such as risk assessments and audits. Such reports provide the data for reporting that the taskforce provides to the LB&I business line.

2.19 The ANAO considers that this hierarchy of work reporting, allied with the formal performance appraisal process that is in place to assess an individual's performance against their performance agreement/expectation statement, represents an effective means for continually monitoring progress against taskforce business plans and required performance levels.

¹⁶ The Taxpayers' Charter is a service treaty issued by the ATO that sets out taxpayers' rights and obligations, the responsibilities of the ATO and its standards for dealing with clients. Taxpayers' Charter standards apply to all Business Lines in the ATO and encompass commitments by the ATO to process returns, reply to correspondence, review objections, answer telephone calls, supply rulings, process registrations and deal with complaints within specified timeframes.

2.20 The ANAO has examined the performance indicators that have been put in place by the taskforce, and the level of performance that the taskforce has reported against them. As the taskforce has met its outcome requirements, the ANAO considers that the taskforce has attained an effective level of performance. It uses effective risk management techniques to determine the activities such as audits that it carries out and maintains a focus on the identification of common themes in tax planning techniques and other HWI behaviour that may have wider implications for compliance and strategic risk management.

Compliance management

2.21 Achievement of the outcomes required of the taskforce depends on its ability to deal with the complex tax planning and business arrangements put in place by some HWIs. The taskforce has established a Compliance Management Strategy to address its responsibilities. The Strategy has a number of elements, including:

- information gathering on HWIs, their associated entities, and tax planning behaviours and practices;
- profiling, risk assessment and analysis of the activities of individual HWIs;
- current year collection of information through the requirement for some HWIs to provide Expanded (tax) Returns;
- audit activity;
- litigation and prosecution;
- development of responses to address any unacceptable tax planning or minimisation practices; and
- research into the HWI taxpayer population and the characteristics of its tax planning or minimisation arrangements.

2.22 The ANAO has examined the taskforce's implementation of its Compliance Management Strategy, the specific components of which are discussed in the following section of this report. The ANAO considers that the Strategy is an effective response to the challenges of dealing with the tax affairs of the HWI taxpayer population.

Identification of HWIs and information gathering

2.23 As noted earlier, the taskforce defines a HWI to be a person who owns or controls net wealth of \$30 million or more.¹⁷

¹⁷ Components assessed in estimation of net wealth for a HWI are discussed further at paragraph 2.36.

2.24 ATO research into the compliance behaviour of the HWI population, as reported at paragraph 1.2, indicated that some HWI taxpayers represent a potentially high risk to revenue through their utilisation of tax planning and minimisation techniques. Identification of a HWI by the taskforce, using an estimate of net wealth, allows the taskforce to then undertake a risk assessment process so that appropriate compliance action can be taken, if warranted.

2.25 Potential HWIs may be identified by the taskforce using a variety of methods such as:

- internal ATO taxpayer databases;
- information received from other ATO business lines, and particularly from staff of industry segments of the LB&I business line;
- scrutiny of public records, such as corporate (public company) databases administered by the Australian Securities and Investments Commission (ASIC), land titles, property sales and ownership records ('data-mining' techniques, using ATO and other databases such as ASCOT (ASIC data), can examine relationships and ownerships in particular business circumstances to lead to identification of a potential HWI); and,
- media review (for example, a media report on a successful stock exchange listing of an emerging corporate entity may establish that a certain individual is to benefit such that he or she may meet the parameters of a HWI).

2.26 At the commencement of the taskforce, potential HWIs were determined using these approaches, and correspondence (known as a 'Round 1' letter) was sent to some selected HWI taxpayers on the basis that information available to the ATO indicated that *they possessed or controlled high net wealth* and that they paid low levels of net tax. The selected taxpayers were asked to answer a comprehensive set of questions about their own business structures and tax affairs and those of their family and associated entities such as trusts and private companies.

2.27 After the first Round, a questionnaire ('Round 2') was forwarded to a further group of HWI's possessing or controlling high net wealth.

2.28 Given its experience with the Round 1 and Round 2 exercises, the taskforce has now refined its approach to information gathering and has developed what is referred to as an 'entity letter'. This letter, which is sent to an identified HWI usually through a tax agent or adviser, can be tailored to individual circumstances and seeks a reduced set of specific information. Information is sought on entities such as trusts and private companies that together form what is known as the 'HWI group'. It

enables the taskforce to gather information about HWIs in a shorter period and at a lower compliance cost, for those HWIs who must provide information, than did the original Round 1 and Round 2 approaches. This letter has been issued to some HWIs ('Round 3'). One of three versions of this entity letter is now used by the Taskforce to investigate newly-identified HWIs and to establish the details of their business and taxation affairs.

2.29 Once identified, the details of a HWI are registered on a HWI list contained within a taskforce-administered, computer-based compliance management system known as the HWI System. The taskforce makes use of the HWI System to:

- produce reports on HWIs at an individual, group or segment level;
- gather information on tax planning and minimisation practices;
- help identify current tax planning techniques and compliance risks;
- provide management reports on levels of performance within the taskforce, eg. on the numbers of HWI subject to the requirement to produce Expanded Returns; and
- maintain the list of identified HWIs (and potential and emerging HWIs).

2.30 Because of the sensitivity of data and information in relation to HWIs, the HWI System has a variety of security levels for the provision of access to its holdings. During the course of the audit, the ANAO observed that only HWI taskforce staff have access to the HWI System, and that most taskforce staff have access to the details of only those HWIs for whom they have been allocated responsibility, for example when they are carrying out the profiling, risk assessment and analysis processes described from paragraph 2.38.

2.31 Once a HWI has been identified, subsequent work such as review of the content of the response to an entity letter is then undertaken by analysts within the taskforce to establish and document on the HWI System the arrangements and links that are in place in the personal business and taxation dealings of the individual. The taskforce has access to powerful software such as NetMap and Analyst Notebook that can assist further analysis of HWIs within the taskforce by illustrating and tracing such links.

2.32 The identification process undertaken by taskforce analysts may find that, on an estimate of net wealth, an individual may not meet the criterion for listing as a HWI. Even if the taskforce takes no further continuing action on the affairs of that individual, the details of the

taxpayer concerned may be forwarded elsewhere within the ATO for further examination should there appear to be a sufficient number of risk factors involved in the tax planning affairs exhibited by the individual from the information available.

2.33 In his 1998–99 *Annual Report*, the Commissioner of Taxation reported that the taskforce had examined the affairs of around 300 HWIs in its first three years. Of these, at that time some 179 HWIs had been examined in greater depth.

2.34 To the end of March 2000, the taskforce has now examined a total of 236 HWIs in greater depth. For the 1997–98 year, the most current year for which a complete set of data is available, due to the extended period in which tax returns can be submitted, analysis by the taskforce shows that:

- these 236 HWIs were associated with a total of 7771 entities, including some 2171 trusts (comprising 1116 discretionary trusts, 667 fixed trusts, 31 charitable trusts and 357 where the trust type was unknown);
- 71 of these HWIs were associated with 10 or more trusts;
- on average, each of these 236 HWIs was associated with some 33 entities, including 22 companies, nine trusts and one partnership;
- average group total assets for these HWIs were over \$270 million; average group net assets were over \$110 million;
- on average, in the 1997–98 year the total tax paid by each HWI and the associated group of entities was \$1.475 million;
- 60 per cent of these HWIs returned taxable income of less than \$198 000 each in the 1997–98 year;
- 60 per cent of these HWIs each paid less than \$40 800 tax in the 1997–98 year;
- average tax paid as a percentage of HWI taxable income was 20 per cent;
- average tax paid by these HWIs has increased by 36 per cent from 1995 to 1998;
- 60 per cent of the groups of entities associated with these HWIs paid less than \$530 000 in tax for the group in the 1997–98 year;
- average tax paid as a percentage of group net income was 13 per cent;
- average tax paid by the groups of entities associated with these HWIs has increased by nearly 49 per cent from 1995 to 1998; and
- as at 30 June 1998, the total carried forward losses of these 236 HWI groups was \$2.7 billion, comprising \$1.7 billion in revenue losses and \$1 billion in capital losses.

2.35 At the time of the audit, the taskforce had included details of more than 500 individuals on its HWI list, including some individuals who could be considered to be 'emerging' or 'potential' HWIs. Individuals in this latter group are monitored periodically. Further action may be taken by the taskforce if their apparent assessed wealth meets the established net wealth criterion in the future or if other risk factors justify it.

2.36 The ANAO accepts that the calculation of individual wealth is sometimes imprecise and cannot be determined simply through examination of balance sheet assets. The taskforce quite appropriately identifies instances of control of assets and entities, as well as outright ownership, for inclusion in the net wealth figure of an identified HWI. A number of HWIs have very complex business affairs with lines of ownership and control encompassing many entities. Many individuals exercise control through their immediate or extended family. The personal business arrangements of HWIs, through personal companies and trusts in particular, are also less available for scrutiny than is the case for public companies. Instances of overseas assets, valuation of intangible assets and intra-group arrangements such as loans and debt forgiveness must also be taken into account in settling on total net wealth to be attributed to an individual.

2.37 The ANAO has examined the process that the taskforce uses to identify the actual net wealth of an individual and, subject to an individual meeting the wealth criterion as a HWI, the method of recording appropriate details on a comprehensive list within the HWI System. The ANAO considers that the taskforce makes appropriate use of both internal ATO systems and of publicly available or purchased database information in order to assess the wealth of individuals for inclusion on the HWI list. The ANAO considers that, within the constraints of dealing with personal business and taxation arrangements of a group of taxpayers some of whom have both intensely private and extremely complicated dealings, the taskforce has established and continues to manage a robust and comprehensive identification process for the actual and potential HWI population.

Profiling, risk assessment and analysis

2.38 Risk assessment is very important within the taskforce. Robust analysis and sound risk assessment within taskforce teams:

- assists in identification of issues involved in tax planning and tax minimisation techniques;

- allows aggregation of data to provide the basis for taskforce-wide analysis of strategies being employed by HWIs and the risks to revenue;
- identifies suitable cases and priorities for further action, such as requiring the HWI and/or associated entities to lodge Expanded Returns (discussed further below), conducting audit activity or proposing legislative action to address issues brought to notice; and
- provides taskforce management with adequate information to allocate resources within the taskforce following formal prioritisation of activities.

2.39 Risk assessment and associated analysis provide a means for the taskforce to determine appropriate risk treatment strategies that should be applied to various levels of compliance exhibited by HWI taxpayers. That is, more robust means of compliance management must be applied as the risk posed to revenue rises.

2.40 The approach requires taskforce team members to consider closely the information supplied by HWIs in response to the query (entity) letters mentioned previously and/or in Expanded Returns. Taskforce analysts prepare reports covering issues such as a background to the HWI and the associated group of entities; an assessment of the HWI's wealth; his or her tax history and that of the associated group; a review of particular features that may represent risk; an indication of possible revenue at risk; and a recommendation as to a risk rating and further action to be taken.

2.41 An overall risk assessment outcome for a HWI and/or HWI group is based on a scale of HIGH—MEDIUM—LOW. In order to decide on an overall ratings outcome, taskforce analysts use a range of criteria in assessing the risk of issues arising within a HWI group, together with their knowledge of the operations of the particular HWI and/or HWI group and the degree of relative risk that the HWI and/or HWI group represents compared to others in the HWI population.

2.42 Present direction from taskforce management is that the overall risk assessment rating is to be based predominantly on strategic risk rather than on audit compliance risk. That is, through the risk assessment process, the taskforce is looking to adopt a strategic approach in the identification of common themes in tax planning techniques and other HWI behaviour that may have wider implications for the HWI population. Having said this, the taskforce may, for example, apply an overall risk

rating of medium to a HWI group, but certain issues or arrangements arising within the group that represent a high compliance risk may still be authorised for audit activity.

2.43 The results and recommendations of each analyst's report must be endorsed by a Team Manager. Before the analyst's report is signed off and details included in the HWI System, quality assurance processes are followed to ensure that analysis and risk assessment functions have been carried out as accurately and comprehensively as possible. These processes may involve peer review of the content of the report and/or consideration of the content of the Report at regional team meetings.

2.44 As stated in paragraph 2.33, the ATO has reported that, in its first three years, the taskforce has examined around 300 HWIs. Based on risk ratings established during such examinations, the taskforce has concluded that approximately 50 per cent of HWIs warrant on-going monitoring by the taskforce. This finding supports the view of the Commissioner of Taxation that:

*not all high wealth individuals show the sort of low tax relative to wealth that attracts our attention.*¹⁸

2.45 The ANAO has examined a number of examples of risk assessment concerning HWIs and has discussed both the method and the practice of performing this function with taskforce staff at the team and management levels. The ANAO considers that, because detailed examination of the taxation affairs of HWIs and their associated groups is resource intensive, the prioritisation of activities that risk assessment allows is vital. The ANAO considers that the taskforce performs the risk assessment and analysis function at a high standard, and that risk assessment reports and, if applicable, decisions to take resulting action (for example, audit or further investigation) are based on the strategic direction of the taskforce to address areas of higher risk.

Expanded returns

2.46 The taskforce continually collects and reviews information on the HWI population:

- to monitor and address the tax planning techniques in use within the HWI segment; and
- to make comprehensive risk assessments of HWIs and their associated entities in the context of that HWI operational group.

¹⁸ Commissioner of Taxation, *A Question of Balance*, address to the American Club, 17 September 1999.

2.47 The taskforce has developed 'Expanded (tax) Returns' that are tailored specifically to the HWI segment. These Returns are intended to provide fuller details of HWIs and their associated entities so that the taskforce can understand more comprehensively how they have determined their tax liabilities. Different Expanded Returns are available for individuals, companies, trusts and partnerships. Together they provide a comprehensive coverage of the tax planning activities of a HWI.

2.48 The requirement to lodge Expanded Returns represents additional compliance costs for some HWI taxpayers, but the ATO has argued that more comprehensive information is essential to effectively manage and improve compliance for this group of taxpayers. Taskforce staff expressed the view that the greater level of disclosure of information that a requirement to report in Expanded Returns represents, may be a positive influence on the compliance behaviour of those required to lodge such Returns.

2.49 During the audit the ANAO examined the Expanded Returns process and the Returns forms in use by the taskforce. It is apparent that the information requested on such Returns is detailed and thus impacts on the cost of compliance on the part of the HWI taxpayer. However, the ATO considers that the complexity and content of the tax planning affairs of some HWIs (those that are subject to the requirement to prepare Expanded Returns) necessitate comprehensive information gathering in order to make appropriate decisions on whether further action such as audit is justified in particular cases. The ANAO agrees with this assessment.

2.50 Following the risk assessment processes outlined above, taskforce policy is that HWIs and/or the associated entities in the HWI group that are rated as High or Medium in terms of risk should, as a general rule, be nominated by taskforce officers to complete and lodge expanded tax returns. The nomination for lodgement of Expanded Returns by a particular HWI group must be recorded on the HWI System for reporting purposes.

2.51 Management of the Expanded Returns process, from when a HWI is nominated for an Expanded Return to the point where Returns are lodged as complete and data has been transcribed to the HWI System, is undertaken by a specific Expanded Returns team (part of the Research and Analysis Team of the taskforce) in the taskforce's Box Hill site.

2.52 Usually, only those entities sufficiently linked to a HWI would be required to lodge an Expanded Return. That is, non-trading trustee

companies, superannuation funds, dormant entities and, in particular, public companies normally would not be selected. While selection for Expanded Returns is done on an annual basis, the taskforce's practice has been that, for proper assessment, analysis and monitoring purposes, HWIs remain in the Expanded Returns process generally for a minimum of two consecutive years.

2.53 Once a HWI and associated entities have been selected to lodge Expanded Returns, they are legally required to comply with this process under sections 161 and 162 of the *Income Tax Assessment Act 1936*. Prosecution action can be initiated by the taskforce if a HWI does not comply.

2.54 Using data contained on the HWI System that has been generated from Expanded Returns, team analysts within the taskforce conduct a desk review of the HWI and the associated group, and update the HWI's risk assessment. Desk review activities include identifying new entities, identifying new risks and assessing the current risk ranking for the HWI. If new risk areas are identified, the risk ranking of the HWI may be adjusted upwards. However, if no further risk areas have been identified and previously identified risk areas no longer exist the risk ranking for a HWI may be downgraded. Taskforce direction is that if the risk ranking is downgraded to low, a HWI should be taken off the Expanded Return process. Further review will take place to monitor the tax performance of a HWI ranked, at a point in time, as low risk.

2.55 The ANAO considers that the Expanded Return process is an effective compliance management technique for dealing with the complex tax planning and business arrangements of the HWI population. While acknowledging the increased compliance costs that Expanded Returns impose on HWIs, the ANAO notes that taskforce decisions to require provision of Expanded Returns are based on risk assessment outcomes. This means that low risk HWIs are generally excluded from such detailed examination and therefore do not have to meet the increased compliance costs that would arise from a requirement to lodge such returns. On the other hand, the information supplied by high and medium risk HWIs that are subject to Expanded Returns benefits the taskforce in its roles of gathering information on tax planning and techniques utilised by HWIs and analysing individual HWI circumstances that may result in taskforce audit activities.

Audit activities

2.56 Following the completion of risk assessment processes by taskforce team members, a taskforce Team Manager or Regional Director may authorise further action for a particular HWI, or for a HWI-associated entity or group. The most common activities are:

- in higher risk cases, full audits of the HWI group ie. the HWI's personal taxation affairs and those of all relevant associated entities;
- audit of (a) specific entity(ies) within the group;
- audit of a specific issue within the HWI group;
- specific enquiries on transactions;
- requirement to submit Expanded Returns in the following reporting period (for further risk assessment using additional information); and
- for a low risk rating, monitoring in future years rather than taking immediate action.

2.57 At the time of the audit there were some 67 audits underway within the taskforce, comprising a mix of full audits and specific issue audits.

2.58 The taskforce has found that the complexity of HWI taxation arrangements—for example, in some cases extensive offshore transactions—has meant that the time taken to complete an audit has been considerable. In part, this has arisen because, while there have been some common issues involved in audits of HWIs, the taskforce has been required to establish the particular facts of HWI cases through examination of individual taxation arrangements. The ANAO noted that the complexity of the tax and financial environment utilised by some HWIs parallels arrangements utilised by clients of other industry segments of the LB&I business line. The Senate Committee's report, referred to earlier, noted that:

*revenue collection in this sector is neither as straightforward nor as easily addressed by process-driven approaches used in other divisions. Rather, it often involves lengthy and complicated audits.*¹⁹

2.59 Staff resources allocated to these audits vary in line with the breadth of enquiries. While specific issue audits have been completed usually within six to 18 months by a single auditor (who could also perform other duties during that period) full audits have taken two to three years to complete and have required a team of two to four auditors on a full-time basis (this highlights how resource intensive such large audits can be).

¹⁹ Senate Economics References Committee, op. cit., p. 46.

2.60 Assessments and loss adjustment notices may be issued as a result of audit activities. However, in cases where contentious or significant issues have arisen during the course of the audit, before the taskforce issues amended assessments, it may provide a position paper to a HWI under audit. Position papers outline the ATO's position as to the level of tax owing, and provide the HWI with an opportunity to clarify facts and to put forward a view as to the HWI's interpretation of the law involved in the matter. Following consideration of a HWI's response to a position paper, the taskforce may decide to issue an assessment for a revised amount as a result of the arguments advanced by the HWI taxpayer, or to issue an assessment for the original amount.

2.61 The ANAO has examined documentation concerning a number of audit processes currently underway within the taskforce and has concluded:

- audit priorities are determined as a result of an effective risk assessment process, described earlier in this report;
- management of audit processes within the taskforce is continuous;
- reports on the progress of audits are provided to the Executive of the taskforce both verbally and in writing on a regular basis; and
- audit teams can secure technical support from within the taskforce, and from other ATO resources such as the Tax Counsel Network (TCN), as required during the conduct of the audit (that is, adequate technical support is available).

2.62 A major outcome of the taskforce's audit activities has been the raising of significant tax revenue, despite dealing with complex tax planning arrangements. The ANAO's discussion of the revenue outcomes of the taskforce is set out from paragraph 3.3.

2.63 The ANAO has noted that, in some circumstances, audit issues identified through the taskforce's risk assessment process, and audits of particular entities, have been handled by other areas of the ATO or have been done by joint teams, drawing on resources provided by both the taskforce and other ATO functional groups. This has been particularly apparent with some industry segments from the LB&I business line taking on HWI audit cases.

2.64 Given the wide-ranging and complex business activities engaged in by some HWIs, the expertise that other areas of the ATO can provide during the audit process is important in securing an appropriate outcome. The ANAO considers that such arrangements should be pursued when possible in order that appropriate audit coverage is given to HWI issues and tax planning arrangements.

2.65 The ANAO has noted also a number of instances where the taskforce has taken a leading role in audit activities across ATO business lines as appropriate. For example, some HWIs have been involved in film investment schemes. The taskforce has been involved in auditing relevant arrangements used by HWIs and in dealing with a number of ATO operational issues relating to such schemes. Officers of the taskforce have coordinated the ATO's responses to such schemes—this has involved both the Small Business (SB) and LB&I business lines. The ANAO supports this flexible and effective means for handling cross-segment and cross-business lines cases.

Litigation and settlement

2.66 The ANAO has been informed that the taskforce's experience has been that HWIs and their advisers will generally seek to settle issues involving disputed assessments in preference to undertaking litigation.

2.67 Disputed assessments are inevitable given the complexity of tax arrangements utilised by some HWIs and the differing interpretations that can be applied to the provisions of existing tax law. That is, there are circumstances in which the amount of tax payable is not clear. At February 2000, 13 HWI cases were on hand where tax outstanding is disputed. In some cases, the factual and legal complexities and difficulties in obtaining evidence mean that cases of disputed assessments would be unsuitable to proceed to court, and are best resolved if an appropriate result can be achieved by means of settlement.

2.68 The ANAO has noted the request of the Senate Economics References Committee for the ANAO, in the context of this audit, to consider the taskforce's approach to handling tax in dispute.²⁰ In undertaking this task, the ANAO noted that paragraphs 7.8 to 7.11 of the Report of the Senate Committee²¹ provide an effective summary of the rationale behind the ATO's use of settlements.

2.69 The ANAO has examined the details of the majority of the 15 cases involving HWIs that have been settled since July 1996. We assessed the processes leading to agreements against the *Code of Settlement Practice* that applied at the time.²²

²⁰ Senate Economics References Committee, op. cit., p. 64.

²¹ Senate Economics References Committee, op. cit., pp. 69–70.

²² The ATO updated its *Code of Settlement Practice* in September 1999.

2.70 In short, within the taskforce, the settlement process involves the following steps:

- the audit case manager—
 - examines the returns of a HWI or HWI entity/group;
 - develops a position paper including a record of the taskforce’s view as to the amount of tax payable;
 - deals with the client’s response to the position paper, provided through the HWI’s taxation adviser or agent; and
 - holds discussions with the adviser;
- when agreement is reached on the tax treatment of the issues between the taskforce case manager and the HWI tax adviser, an Agreement Document is prepared;
- at least two senior level officers, usually the case manager and a TCN officer or the First Assistant Commissioner of the taskforce, are involved in the signoff of the Agreement Document, that is, the decision to endorse the agreed amount of tax owing;
- often, advice is obtained from tax counsel and can be sought at any stage in the process, including before final agreement is reached between the parties; and
- the taskforce then issues an Assessment Notice as to any amount payable, and records the revenue collection when payment is received.

2.71 The ANAO has found that the taskforce conducts settlement processes in accordance with the ATO’s *Code of Settlement Practice*. Our view is that settlement processes have been conducted with a view both to protection of the revenue outcomes possible and to the on-going maintenance of fairness to the HWI taxpayer concerned.

2.72 Although settlements may be appropriate in some cases, the on-going positive compliance effect of taking issues to the courts is an important consideration. This is especially so where taking the case forward is designed to clarify the operation of the law in relevant cases. The taskforce has found also that, in some cases, litigation has been necessary in order to obtain access to documentary evidence on the activities of a HWI, rather than to test the tax law. In addition, the ATO has advised that there are some higher profile HWIs who would be prepared to take the ATO to court in order to argue the merits of a particular tax planning arrangement.

2.73 As at February 2000, a number of cases arising as a result of taskforce activity were currently in the Courts or likely to result in litigation. At that time there were 11 HWI groups that had cases awaiting hearing in the Federal Court or the Administrative Appeals Tribunal. Since July 1996, cases involving four HWI groups have been decided by the Courts, with two of the four cases involving substantive tax liability issues.

2.74 During the course of the audit the ANAO examined the processes in a number of particular cases that have led to litigation involving HWIs and/or their entities or in which litigation is likely. The taskforce employs a system of management reporting such that the decision to put a matter to the courts is well documented and is defensible on the basis of the merits of the case. Moreover, the management of particular cases while court processes are underway involves constant reporting within the taskforce, and recording of decisions and advice as to the ATO/taskforce 'line' to be pursued.

2.75 The ANAO supports the direction being taken with the taskforce's litigation practices, and notes that use of the courts, including for clarification of the tax law through decisions on particular cases, substantially assists the taskforce in carrying out its compliance strategies. Decisions of the courts following litigation also assist taxpayers to understand the position at law.

Internal evaluation

2.76 As discussed at paragraph 6, in 1998 the ATO commissioned an evaluation of the work of the taskforce. It was a mid-term review of the taskforce's effectiveness. Consistent with the dictates of good corporate governance, the objectives of the evaluation were to evaluate the effectiveness of the first two years of the taskforce's activity and to recommend any improvements to the on-going management of compliance by HWIs, particularly strategies to assess and treat risks to compliance.

2.77 Key determinants of effective evaluations²³ include:

- the primary focus of the evaluation is on the achievement of Government objectives;
- evaluations identify key features of the operation;
- good quality officers are selected to manage the evaluation;
- stakeholder groups are involved;

²³ 'Good Practice Principles for Evaluations', in Audit Report No.3 1997–98 *Program Evaluation in the Australian Public Service*, ANAO.

- the evaluation is integrated into the overall performance management framework;
- recommendations for improvement are made and prioritised;
- recommendations are endorsed at senior management levels; and
- implementation of recommendations is included in the program's management plan.

2.78 The ANAO took account of these principles in carrying out our assessment of the ATO's evaluation process. ANAO audit activity, including site visits, was conducted to confirm the findings of the internal evaluation and to identify how recommendations were being implemented.

2.79 As part of the ATO's evaluation an external consultant was engaged to examine the taskforce's compliance management strategy. In particular, the views of some advisers to high wealth individuals were canvassed in order to assess critically the work of the taskforce and to identify ways of improving compliance. As the consultant represented a degree of independent analysis of these external views, the ANAO considered that it was not necessary to repeat the exercise in its audit coverage. Nevertheless, the ANAO did contact a limited sample of tax advisers who had been involved in the ATO's evaluation process to ascertain their current views on some of the issues that had been considered as part of the evaluation.

2.80 The other part of the evaluation was an internal review of the operations of the taskforce and on the effectiveness with which it achieved the objectives set by the Government. The methodology used included documentary review, interviews and focus group discussions at all levels of the taskforce and comparison of compliance practices. It was conducted by an experienced ATO auditor external to the taskforce.

2.81 The evaluation found that the objectives of the taskforce were being achieved. It also identified areas where improvements could be made. In particular, it identified that refinement of goals and compliance strategies, improved communication and coordination and maintenance of skills through training would enhance the success of the taskforce.

2.82 The evaluation found also that advisers sought increased communication with taskforce staff and reported generally that in the contact they did have, they found the staff to be fair and professional. Another closely linked improvement sought was better feedback from the taskforce on the examination of Expanded Returns. The compliance cost of preparing additional information required by the Expanded Return was a major concern. The ANAO observed that relevant recommendations were being implemented appropriately.

2.83 Another aspect to come out of the review was the lack of knowledge of the outcomes achieved by the taskforce. One of the important features of the ATO's Compliance Model²⁴ is that encouragement of compliance is enhanced by public recognition of a tax system that has a capacity to enforce the law. Wider publication of the results of taskforce activity could very well contribute to an improved public perception of the tax system. The Senate Economics References Committee has made a similar point.²⁵

2.84 One of the principles of better practice in conducting evaluations is the public communication of findings and recommendations. The ANAO notes that the advisers who participated in the evaluation received a letter from the ATO that summarised the recommendations in general terms and indicated the ATO's intention of addressing them. Such action is commendable but falls short of public communication especially when a major recommendation urged greater publicity.

2.85 In reviewing the ATO's evaluation outcomes, the ANAO received advice from a sample of advisers suggesting that they have seen a general improvement in the operations of the taskforce. They continue to express concern over the cost of compliance involved in completing the Expanded Returns, but recognise generally the need for the ATO to obtain additional information on complex arrangements. The number of HWIs required to submit Expanded Returns has reduced. Their comments suggest that there is still a need to improve the provision of feedback to those HWIs who are still required to complete Expanded Returns.

2.86 The advisers contacted by the ANAO noted also that the outcomes of the taskforce are not widely known. It was suggested that information on performance and outcomes could be disseminated via industry seminars, and industry and professional bodies such as the Taxation Institute of Australia.

2.87 Consistent with better practice principles to enhance the impact of evaluations, the findings and recommendations of the evaluation were considered by team managers and subsequently endorsed by the taskforce executive. Implementation plans were developed and incorporated into the taskforce business plans. In this way, regular reporting and monitoring of implementation were effected.

²⁴ As part of its risk management approach, the ATO's Compliance Model represents a framework within which it manages all taxpayer relations. The Model recognises that the majority of taxpayers comply voluntarily with no need for ATO intervention, others comply but need some assistance or prompting, while others will not comply in the first instance but will if prompted further. A small number will not comply and may need enforcement action.

²⁵ Senate Economics References Committee, *op. cit.*, p. 66.

2.88 ANAO audit activity confirmed the findings of the ATO's internal evaluation of the operations of the taskforce. The ANAO considers that the internal evaluation provided a comprehensive review of key management issues and that its recommendations were practical and consistent with the evaluation findings.

Coordination of ATO effort

2.89 As part of its examination of the operations of the taskforce, the ANAO has undertaken an examination of taskforce strategies aimed at ensuring that appropriate ATO staff, particularly those who are responsible for examining taxation planning in other business lines, are kept informed of relevant developments identified by the taskforce. This is important as the taskforce has responsibility for a segment of the taxpaying population that, firstly, has not been examined previously in a targeted fashion and, secondly, has access to tax planning advice and techniques that could well impact on the overall integrity of the tax system if implemented widely within other parts of the community.

2.90 The ATO has set up its workforce to focus on the special characteristics of particular segments of the Australian taxpaying population. The organisation is structured into divisions known as business and service lines. Each business line is responsible for a major market segment, such as individuals, small business or large business. Within these business lines, particular segments deal with specific issues relating to the characteristics of a particular industry. The complexity of arrangements and structures associated with HWIs has meant that the taskforce is dealing with issues that cut across the usual segment treatment by the ATO.

2.91 We noted at paragraph 2.65 that the taskforce has taken the lead role in a number of joint projects. It follows that the taskforce can benefit from the specific expertise of a variety of the industry segments when dealing with one HWI. Similarly the intelligence gained from analysis of HWIs can be of benefit to those industry segments.

2.92 In its examination of taskforce material the ANAO noted that from its earliest days the taskforce had undertaken coordinated action with other ATO areas on a number of occasions. Nevertheless, the mid-term evaluation identified that better liaison with other areas of the ATO would lead to a better work product. This would overcome the earlier criticisms that different sections of the ATO had been pursuing the same issue resulting in taxpayers having to deal with more than one team from

the ATO. The ANAO observed cases where contact with other segments of LB&I and also other business lines had subsequently been established and a coordinated approach taken to progress the issues involved.²⁶

2.93 More recently, the ATO has given recognition to the common areas of interest of the taskforce, the Strategic Intelligence and Analysis segment of the LB&I business line and the on-going ATO project examining tax planners, by placing these elements under the direct control of the one First Assistant Commissioner (the first Assistant Commissioner in charge of the HWI taskforce). This same officer is also co-chairman of the ATO's Aggressive Tax Planning Steering Committee which provides organisational leadership on addressing aggressive tax planning arrangements.

2.94 Staff of the taskforce also use Signum, a national ATO database for recording significant technical tax issues, to keep track of the major issues identified during their investigations. It enables the ATO to identify issues of common interest to more than one area and to have them resolved according to their assigned priority.

2.95 The ANAO has concluded that appropriate administrative arrangements and information systems are now in place to support coordination of the work of the taskforce with other relevant areas of the ATO.

²⁶ For example, in a pilot arrangement, the taskforce's staff in Brisbane work as a joint taskforce/ Strategic Intelligence and Analysis team.

3. Taskforce Outcomes

This Chapter discusses the outcomes that the Government has required the taskforce to achieve, the ANAO's assessment of the taskforce's performance against those required outcomes, and the future for the taskforce.

3.1 In summary, the Government's decisions to provide additional resources to the ATO required the HWI taskforce to accomplish two outcomes:

- undertake on-going investigation and management of the payment of income tax by high wealth individuals (to yield an estimated \$100 million in additional revenue in each of 1997–98, 1998–99 and 1999–2000); and
- develop progressively administrative responses and, with Treasury, legislative proposals to address undesirable tax minimisation practices as they are identified.

3.2 We report below on the taskforce performance against these requirements.

Revenue

3.3 The activities of the HWI taskforce, particularly a visible compliance and law improvement program directed at HWIs, can be seen as a means of enhancing public confidence in the equity of the operation of the tax system. The taskforce's activities and the degree to which they are successful are important for the integrity of the tax system. If the general community of taxpayers have a perception that HWIs are able to avoid the compliance activities of the ATO, then they may be disposed to follow the lead established by HWIs. The implications for revenue collection are clear if there is a diminution in the overall degree of compliance in the payment of taxation at an individual level.

3.4 To counter such perceptions, the Commissioner of Taxation has indicated his intention to maintain and enhance public confidence in the integrity of the Australian tax system and in the ATO's treatment of individuals across wealth and income segments. With the relatively high profile of the taskforce, he has used a range of public and semi-public settings to emphasise that HWI tax affairs are being looked at in some detail and that revenue has been gained from HWIs and their associated entities through audit and other activities of the taskforce. The ANAO is aware that opportunities taken by the Commissioner to publicise the taskforce and its operations have included appearances before

Parliamentary Committees, including the Senate Economics References Committee during its Inquiry into the Operations of the ATO, addresses to professional bodies, and media interviews.

3.5 The ANAO notes that the taskforce has assessed both the additional direct and indirect revenue outcomes that have resulted from its activities since 1996. The ANAO has examined the taskforce's revenue claims, both direct and indirect, against the Government's required revenue targets of \$100 million in each of 1997–98, 1998–99 and 1999–2000. We report on these outcomes from paragraph 3.9 (direct revenue) and paragraph 3.15 (indirect revenue). Details of the quantum of losses denied or adjusted by the taskforce, which result in increased taxation revenue in later years, have also been examined and are discussed from paragraph 3.30.

3.6 During its investigation of the taskforce's claims regarding achievement of required revenue outcomes, the ANAO noted that the taskforce has reported its revenue results previously in a number of formats and with some adjustment of figures between and within years of collection. The ANAO is satisfied that the revenue and adjusted loss results discussed below have now been confirmed by the ATO and provided in a standardised format such that they represent a comprehensive picture of actual outcomes. However, the ANAO considers that the consistency of the taskforce's reporting arrangements could be improved in the future.

Recommendation No.1

3.7 The ANAO recommends that the ATO report the HWI taskforce's revenue outcomes on a consistent and standardised basis so that the taskforce's level of achievement is more readily discernible from year to year.

ATO Response:

3.8 The ATO agrees with the recommendation.

Direct Revenue

3.9 The ANAO has examined the process for recording the achievement of revenue²⁷ collection outcomes within the taskforce.

²⁷ 'Revenue' is not used in an accrual accounting sense, but refers to cash collections.

3.10 Revenue is not recorded as 'achieved' until the actual payment has been received and accounted for against the ATO's assessment of tax owing or, in the case of voluntary disclosures by the taxpayer, against the details of the taxpayer. The revenue outcome is recorded on the ATO system known as CASES that records progress with each case in which the ATO is involved. This system records the achievement of revenue 'in the door' against the details of the particular case once the actual payment of tax owing by the taxpayer or entity has been received in the ATO.

3.11 Further it is not possible to double-count the achievement of revenue to more than one ATO segment or team as CASES will reject such entries until the discrepancy is adjusted and revenue, as the case outcome, is attributed to one segment within the ATO (such as the HWI taskforce).

3.12 The ANAO has noted that the taskforce records only those direct revenue outcomes that result from its own audit and other investigation actions that have been applied to a particular HWI and/or HWI group or associated entity. Audits may result in amended assessments; in such cases collections, when received, are counted as additional revenue attributable to the operations of the taskforce, and hence available for reporting against the Government's revenue requirements for the taskforce. Action taken by the taskforce, for example to identify and assess the risk parameters of a HWI, may be associated with voluntary disclosure of tax payable (in 1998–99 five such cases resulted in an additional \$4.5 million in revenue). Such results would be recorded also against the taskforce's revenue requirements.

3.13 On the other hand, the taskforce does not attribute to its own activities the net tax payable by HWIs and their associated entities that is paid where there is no taskforce action on the individual or entity concerned. For example, in 1997–98, over 1000 private companies that were associated with identified HWIs but that were not subject to audit, paid some \$429 million in net tax; none of this was attributed by the taskforce towards the direct revenue outcomes that the taskforce reported for that year (although, by definition, part of this figure would be claimed as indirect revenue gains for that year arising from the operations of the taskforce; indirect revenue is discussed from paragraph 3.15 to 3.28).

3.14 The ANAO has examined the revenue report for the taskforce for the year ended 30 June 1999. We have noted that each transaction is recorded against a particular HWI, and that collections have been recorded in a manner such that the overall direct revenue outcome for the year is readily discernible. Accordingly, the ANAO considers that direct revenue outcomes reported by the taskforce are supportable.

Indirect Revenue

3.15 The attribution of an indirect change in taxation behaviour of individuals and companies, as a result of compliance activities other than on them directly, is difficult to quantify and, certainly, cannot be proven as correct or otherwise. Nevertheless, the taskforce has reported on the indirect revenue gains that have been made from HWIs as individuals and from HWI companies as a compliance by-product of taskforce activities within the HWI segment of the taxpayer population. The ANAO sought to assess whether the attributions contained in the taskforce's reports were a reasonable account of the effect of taskforce activities.

3.16 To compile its reports on indirect revenue outcomes, the taskforce engaged the services of the Revenue Analysis Branch (RAB) of the ATO. The members of this Branch typically work with the Treasury in preparing predictions as to the behaviour that taxation revenue will exhibit should certain taxation legislation measures be introduced by Government.

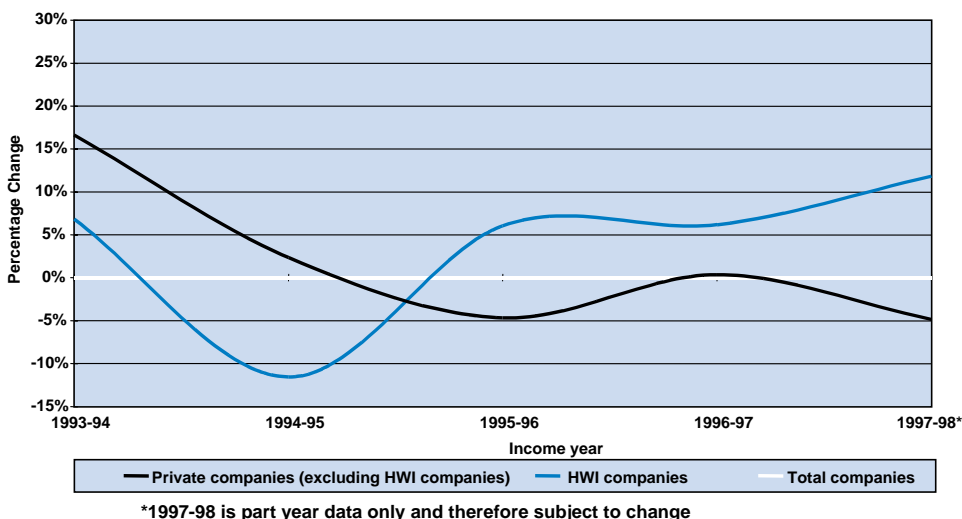
3.17 So that it could measure macro outcomes from the work of the HWI taskforce, RAB was provided with a dataset containing tax file numbers (TFNs) of taxpayers who had been identified as being in the focus group for the HWI project. The TFNs comprised those of companies, individuals and associates of the identified individuals. Using internal ATO databases RAB compared the growth in net tax paid by these HWI entities with the growth in net tax paid by a larger population group from which the HWI population had been extracted—HWI companies' growth was compared with the growth of taxable private companies while HWI individuals' growth was compared with the growth of taxable business individuals.

3.18 The ANAO has discussed this matter with RAB officers, examined the methodology used by RAB in calculating the indirect revenue outcomes for both 1996–97 and 1997–98 (this is the latest income year for which data is available) and taken account of the content of RAB working papers. The ANAO notes that RAB has advised the taskforce that, with an important qualification as to the difficulty in measuring with a high degree of certainty the results of compliance improvement projects, especially those with voluntary or indirect impacts, the results of its analysis provide evidence that the HWI project has resulted in indirect revenue benefits.

3.19 Using the results of RAB analysis, Figure 1 shows changes in net tax paid since 1993–94 for HWI-controlled companies, compared to other private companies (net tax paid by total companies is kept constant for comparison purposes). It provides evidence that since the creation of the taskforce, tax paid by HWI-controlled companies has increased by more than that paid by other private companies.

Figure 1

Change in net tax paid by HWI companies and other private companies compared to net tax paid by total companies 1993–94 to 1997–98



Source: ATO.

3.20 For the 1996–97 and 1997–98 income years,²⁸ RAB results are that net tax collected from HWI companies was, respectively, \$48 million and \$104 million, and from HWI individuals and associates was, respectively, \$5 million and \$5 million, above that which would have been paid if the HWI companies and individuals had grown in line with comparable private companies and business individuals. These results have been used in the reports by the taskforce to the Department of Finance and Administration (DOFA), discussed from paragraph 3.36.

3.21 Based on its analysis of the methods used by RAB, the ANAO considers that the derived indirect revenue figures for the 1996–97 and 1997–98 years of income represent a reasonable estimate of indirect revenue resulting from the activities of the taskforce.

3.22 The taskforce's direct and indirect revenue outcomes since it was created in 1996 are summarised in Table 1.

²⁸ Tax collections attributed by RAB to the 1996–97 and 1997–98 years of income would in fact have been received during, respectively, the 1997–98 and 1998–99 financial years. This is due to the lag in submission and processing of income tax returns.

Table 1
HWI Taskforce
Revenue Outcomes

<i>Year of Collection</i>	<i>Direct Revenue (\$m)</i>	<i>Indirect Revenue (\$m) ⁽¹⁾</i>	
		<i>Companies</i>	<i>Individuals</i>
1996–97	37.804	28	3
1997–98	23.014	48	5
1998–99	63.890	104	5
1999–2000	⁽³⁾ 38.867	⁽²⁾	⁽²⁾
TOTAL ⁽⁴⁾	163.575	180	13

Source: ANAO analysis of ATO quantitative data.

Notes:

- (1) Indirect revenue figures are derived, as described from paragraph 3.15 onwards, rather than representing actual cash collection figures, and hence are shown as rounded figures.
- (2) Indirect revenue impacts of taskforce activities are not available yet for the 1999–2000 year as calculations can only be completed when processing of all income tax returns for the year has been completed.
- (3) Direct revenue collections for 1999–2000 apply up to 14 April 2000.
- (4) As a result of rounding, individual components may not add to totals.

3.23 The Government did not set a target for revenue to be raised by the taskforce in 1996–97 as raising revenue through new compliance intensity and the issuing of revised tax assessments, normally as a the result of an audit, involves long periods of time. However, as shown in Table 1, taskforce figures show a direct revenue outcome in 1996–97 of \$37.804 million.

3.24 The ANAO has sought a view from the taskforce on the reasons for the variations in direct revenue collections from year to year, as shown in Table 1. The taskforce has offered the explanation that, for HWIs, some of the amounts involved in assessments of taxation owing or agreed settlements are substantial. When collections are received in such cases, they have had a significant impact on the collections for the year in which they occurred. For example, one settlement involved a payment of \$25 million. That single receipt was greater than the total direct revenue collected in 1997–98, and so by itself had a large impact on revenue figures at the time that it was made. Other than this observation on the effect of a significant payment on revenue outcomes, the ANAO has been informed that the taskforce has not analysed the flow of revenue collections for trends or patterns.

3.25 Figures shown as direct revenue in Table 1 record actual cash collections received. That is, they do not include amounts in dispute or amounts subject to payment arrangements (negotiated payment agreements extending over a period).

3.26 The ANAO has been informed that an additional \$16.443 million has been collected by the taskforce but is not included in Table 1 as revenue because it comprises amounts subject to dispute with the HWI taxpayers concerned (that is, the ATO may, at the conclusion of taskforce work on individual cases, be required to repay to the taxpayers some such amounts already collected).

3.27 At the time of the audit, taskforce figures show that assessments have been issued for an additional \$315 million in tax payable by HWIs and their associated entities but, as these amounts are in dispute, the assessments have not yet resulted in collection of revenue. Further, at the time of the audit, the taskforce had secured additional direct revenue of \$33 million that was subject to negotiated payment arrangements extending over a period of time. These latter amounts are not recorded against revenue achieved until actual collections of tax payable are received.

3.28 During the course of the audit the ANAO became aware that, as a result of completion or near-completion of a number of long-running audit cases, some large assessments of tax payable had been issued or were about to be issued to HWIs and/or their associated entities. There is the possibility that objections and/or litigation will be involved in some of these cases. Therefore, it is not possible to calculate details of the final revenue to be raised through payment against these assessments. Nevertheless, following issuing of such assessments, revenue generated by taskforce activities is likely to increase significantly in later collection years.

Conclusion

3.29 The taskforce has achieved its revenue targets for 1997–98 and 1998–99. The collections that occurred in 1996–97 were included in accounting for the 1997–98 target. They were achieved earlier than anticipated, as there was no target set for 1996–97. As indicated in Table 1, the results for 1999–2000 will not be available until after the end of the financial year and when complete data are available for analysis.

Adjustment of losses

3.30 While not required to be reported as part of the outcomes sought by Government in relation to the taskforce's additional funding, the taskforce has also recorded the total of adjustments (that is, reductions) made by the taskforce to losses claimed by HWIs. These figures have been included in the taskforce's reports to DOFA, discussed from paragraph 3.36. Adjustments of claimed losses by the taskforce result in additional revenue in future years, but calculations of the tax to be gained from such adjustments are difficult and depend on the particular circumstances of the HWI.

3.31 In reports to Government and within the ATO, the taskforce has reported on the significant losses carried forward by the HWI segment.²⁹ This area has continued to be a major concern to the taskforce as offsetting revenue and capital losses against income is a significant reason why relatively low amounts of tax are being paid at both the individual and group level by some HWIs. While tax legislation allows for use of losses to reduce taxable income, creation of 'artificial' losses by taxpayers has been disallowed by the ATO where appropriate.

3.32 Areas of concern include the creation of losses through:

- intragroup transactions such as debt forgiveness, payment of interest, management and service fees, etc.;
- trading stock revaluation;
- R&D syndication deductions;
- purchase of loss entities; and,
- film investment schemes.

3.33 In the Commissioner of Taxation's *Annual Report 1998–99*, the ATO reported its concern about two of these areas in particular, that is, R&D activities, and film schemes. Legislation has been enacted (in 1996) to address the abuse of the research and development concession through syndication, but the taskforce is still investigating cases that it considers raise serious concerns about deductions for R&D core technology. Film investment schemes are the subject of continuing audit activity by the taskforce.

3.34 The ANAO notes that the Government has taken action on what it and the ATO have perceived as structural deficiencies in the law involving the use of revenue and capital losses. On 10 December 1999, the Treasurer announced that legislation had been passed to address tax minimisation and avoidance opportunities, including preventing loss duplication and value shifting, and that further loss measures involving linked company groups would apply from 21 October 1999, the date of introduction of the relevant legislation into Parliament.

3.35 At the same time as legislative change is being implemented, under existing legislation the taskforce has undertaken audit activities since 1996 concerning claims made by HWIs and their groups in the areas of revenue losses and capital losses carried forward. Table 2 summarises the results of adjustments flowing from the taskforce's activities.

²⁹ The Commissioner of Taxation's *Annual Report 1998–99* reported at page 17 that analysis action on about 300 HWIs revealed aggregate losses of \$3.5 billion being carried forward at 30 June 1997.

Table 2**HWI Taskforce****Adjustments to losses claimed by HWIs and/or HWI groups**

<i>Year of Adjustment</i>	<i>Reduction in revenue loss (\$m)</i>	<i>Reduction in capital loss (\$m)</i>
1997–98	196.068	56.921
1998–99	243.763	381.481
1999–2000 ⁽¹⁾	6.640	9.021
TOTAL ⁽²⁾	446.471	447.423

Source: ANAO analysis of ATO quantitative data.

Notes:

(1) Reductions in losses made during 1999–2000 are up to 14 April 2000.

(2) As a result of rounding, individual components may not add to totals.

Taskforce reporting to the Department of Finance and Administration

3.36 The ANAO notes that the taskforce has prepared a Memorandum of Understanding (MoU) with DOFA covering the recording of revenue raised by the taskforce. This MoU is associated with the additional funding provided to resource the taskforce. During the course of the audit the ANAO was unable to find evidence that this MoU had been signed by the respective parties. However, the intentions behind the MoU largely have been carried out and the period of additional funding, that gave rise to the MoU, is to expire shortly. DOFA advised in discussions with the ANAO that it does not wish to insist on the formalities contained in the MoU because ATO practice, as carried out by the taskforce, appropriately meets DOFA requirements for reporting on revenue outcomes.

3.37 In reporting to DOFA on taskforce revenue outcomes in the spirit of the MoU, the taskforce provides reports on direct and indirect revenue and the extent of loss adjustments made. For direct revenue, the taskforce provides a collections certificate of assurance for DOFA as to the amount of direct revenue raised by the taskforce in a particular year. The collections certificate is prepared by the ATO's Internal Assurance Branch, following examination of taskforce records and data. Internal Assurance Branch audit procedures include verification of the dates and amounts of payments recorded by the taskforce on ATO accounting records where applicable.

3.38 The ANAO has examined both the process and the working papers used in relation to the issuing of the certificate of assurance for HWI revenue collections in the year ending 30 June 1999 and concludes that the internal audit opinion as to the extent of direct revenue collections by the taskforce is soundly based.

Taskforce involvement in addressing tax minimisation techniques

3.39 In commenting on the achievements of the HWI taskforce in his *Annual Report* for 1998–99, the Commissioner of Taxation noted³⁰ that reasons why some HWIs and their associated entities pay relatively little tax compared to their apparent wealth include:

- tax free distributions from trusts;
- non-cash benefits and loans from both trusts and companies to individuals;
- capital gains not liable for tax;
- tax deductible gifts;
- negatively geared property holdings generating annual interest deductions;
- tax concessions such as deductions for research and development and building construction expenditure;
- accumulation of wealth offshore and no evidence to prove avoidance of Australian tax;
- acquisition of companies and trusts with tax losses which are able to be used to shelter income; and
- genuine tax losses from business operations, for example, primary production activities which shelter income from profitable activities.

3.40 One of the objectives of the HWI taskforce was to identify and provide advice on tax planning techniques being utilised by HWIs, and to recommend areas requiring reform through subsequent legislative action to address some of the undesirable elements of these activities.

³⁰ Commissioner of Taxation *Annual Report 1998–99*, p. 16.

3.41 The ANAO has sighted evidence that the taskforce has provided a number of substantial reports covering tax minimisation techniques in use by some HWIs and that it has suggested areas for systemic policy reform to Government. The ANAO is aware also that the taskforce has circulated a number of internal working papers within the ATO covering both identified questionable tax planning techniques and possible action that may be taken to address them.

3.42 However, as legislative amendments in the taxation area are commonly initiated and developed through joint input within the ATO, and indeed with Treasury involvement, it is not possible to attribute action taken by Government to legislate in particular areas, including those affecting HWIs, as being solely the result of the activities of the taskforce. Nevertheless, it is clear that taskforce examination of techniques used by HWIs, who are a well-advised and resourced segment of the taxpayer population, and subsequent advice by the taskforce, whether internal to the ATO or otherwise, have contributed information that the Government has acted upon, for example in the case of the legislation affecting losses, noted at paragraph 3.34.

3.43 In recent years the Government has introduced a number of legislative measures to remove tax minimisation opportunities formerly available to HWIs (and other taxpayers), that address:

- abuse of R&D syndication;
- exploitation of the former infrastructure borrowings concession;
- trust losses;
- private company dividends disguised as loans;
- misuse of charitable trusts to distribute funds overseas;
- franking credit trading and dividend streaming;
- taxation of foreign source income;
- creation of artificial capital losses;
- tax minimisation through luxury car leasing arrangements; and
- loss duplication and value shifting.

3.44 The taskforce has noted in its reports to Government that legislation enacted in these areas has removed some deficiencies in the law and that this will contribute to the delivery of revenue previously identified to be at risk from the planning and minimisation arrangements used by some HWIs.

3.45 On the basis of evidence gathered by the taskforce to date, the taskforce considers that the most significant systemic generators of tax planning by HWIs are the use of trusts and related party or intra-group transactions. The ATO expects that the Government's proposed business tax reforms, including the taxation of trusts through the new entity tax system, will address major deficiencies in the current tax system. Proposed reforms include also the development of a consolidation regime for wholly owned companies and trusts and the removal of grouping concessions for non-consolidated entities. As noted earlier, legislative reforms to address loss duplication and value shifting have already been enacted.

3.46 The First Assistant Commissioner of the taskforce has been involved in extensive briefings on business taxation issues with other areas of the ATO, with the Treasury, with the Tax Reform Taskforce, with the Ralph Committee (Review of Business Taxation), and with the Treasurer, drawing on the experience that the taskforce has gained in dealing with the affairs of the HWI group of taxpayers. In the light of evidence gathered on tax minimisation practices used by HWIs, the taskforce prepared a paper for the Tax Reform Taskforce outlining some areas for systemic policy reform that were designed to increase HWIs' share of the overall tax burden.

3.47 The taskforce considers that the legislative measures already introduced and the proposed reforms arising from the Government's decisions on business taxation in particular, will provide a systemic response to some of the identified deficiencies in the law which are being exploited currently by some HWIs.

3.48 The ANAO notes that the taskforce's function of investigating and reporting on tax planning techniques is on-going, that is, it is to continue past the end of the taskforce's additional funding in June 2000. For example, as noted earlier, the First Assistant Commissioner of the taskforce is the co-chairman of the ATO's newly-established Aggressive Tax Planning Committee.

3.49 The ANAO confirmed that advice provided by the taskforce to Government has resulted in initiatives, including legislation now in force and proposed, to address a number of tax planning techniques in use by HWIs. The ANAO has been made aware that the impact of the Government's changes in business taxation in particular should add to the delivery of revenue previously identified as being at risk in the HWI population.

Taskforce reporting of outcomes

3.50 The report of the Senate Economics References Committee made the statement that:

*Publishing the results of and issues involved in the Taskforce's operations are important for community education and compliance.*³¹

3.51 For both revenue and legislative advice outcomes, the ANAO sees merit in the ATO preparing a summary of the taskforce's performance over the years of its existence.

3.52 While there has been some public release of information on the taskforce's activities, as acknowledged elsewhere in this report, the external reporting of the taskforce's performance that has taken place since its creation has been provided in various circumstances and formats, and could have been more comprehensive. Having said this, the ANAO acknowledges that, given the necessary length of time that some of the taskforce's functions require before outputs are gained, for example audits of HWI groups, the extent of information that the taskforce could make available publicly to the present time has been somewhat limited.

3.53 The ANAO acknowledges and supports the augmented release of information on HWI taskforce activities provided in the Commissioner of Taxation's *Annual Report 1998–99*. This release of more detailed material than previously allows for more informed public and Parliamentary scrutiny of the activities of an important and relatively high profile ATO function. The format and content of the Annual Report information could well provide a template for the release of enhanced public information on the operations of the taskforce in the future. The ATO could achieve better public dissemination of taskforce outcomes by providing the same information via appropriate industry and relevant professional journals.

3.54 The ANAO considers that, in the case of the revenue collection outcomes, a move to more public reporting at the conclusion of the taskforce's additional funding would serve to demonstrate that ATO compliance activities are directed equitably throughout the taxpayer community, and assist in maintaining taxpayer confidence in the integrity of the overall tax system in Australia. At the same time, such information would serve as a means for the Government to advise Parliament on the return that has been gained from its investment of additional funding over four years to the end of June 2000.

³¹ Senate Economics References Committee, op. cit., p. 66.

3.55 Similarly, and noting that it is difficult to establish a consolidated list of legislative change proposals that had been taken up by Government as a result of taskforce advice and initiatives, the ANAO considers that the ATO should report publicly and to Parliament on performance in this area. This could be seen as a further means of enhancing the confidence of the Australian taxpaying community in the ATO's compliance management activities, including in the closing of perceived 'loopholes' in the tax laws.

3.56 The ANAO considers that there is an opportunity for the taskforce to report on its overall performance at the end of its additional funding.

Recommendation No.2

3.57 The ANAO recommends that the ATO report publicly each year on the on-going achievements of the HWI taskforce in terms of:

- the revenue, both direct and indirect, that has been gained through audit and other activities of the taskforce; and
- the initiatives it has taken to address undesirable tax minimisation practices.

ATO Response:

3.58 The ATO agrees with the recommendation.

3.59 Further to this recommendation, and with a view towards enhancing the community's confidence in the equitable operation of the taxation system, the ANAO is supportive of the Senate Economics References Committee in its desire to see the ATO provide an explanation of the reasons that some HWIs pay relatively little tax compared to their apparent wealth.³²

Future HWI work

3.60 The risk ratings resulting from the work of the taskforce, as reported earlier, show that some 50 per cent of HWIs analysed by the taskforce have been rated as of lower risk. Viewed from the context of the ATO Compliance Model, discussed at paragraph 2.83, the way that the taskforce treats HWIs is typical of the ATO's risk management processes across all its business lines.

³² Senate Economics References Committee, op. cit., p. 67.

3.61 On the basis of evidence sighted by the ANAO, the taskforce has succeeded in improving compliance among the HWI community, as discussed earlier in this Chapter.

3.62 An additional benefit arising from a continued focus on the HWI community is the improved public perception of a tax system being equitably administered. This in turn is a contributing factor in encouraging general compliance by the taxpayer community.

3.63 The taskforce has identified a high level of complexity in the structures employed by some HWIs. The existence of these structures and the tax implications of how they interact has required novel analytical approaches by the ATO in determining tax liability. This is a special expertise applicable to this group and should be maintained to ensure proper treatment of HWI taxation issues.

3.64 In addition, HWIs are involved in a broad range of industry segments. In fact, many operate in multiple industry segments. The cross-industry nature of many HWI activities means that they are not easily dealt with by the standard LB&I structure that is based on an industry segment focus. The structure developed by the taskforce to deal with the complexities of this client group has been shown to be effective in achieving the desired outcomes.

3.65 The identification and risk profiling of HWIs is on-going. The list of HWIs has grown to more than 500. As reported at paragraph 2.44, the taskforce has concluded that, on the basis of its risk analysis activities, a significant proportion (approximately 50 per cent) of HWIs examined require on-going monitoring by the taskforce.

3.66 The ANAO notes also an observation recorded during the external consultant's participation³³ in the ATO's internal evaluation of the taskforce's operations that emerging HWIs may present a greater risk to revenue than the more established ones because they are more likely to undertake aggressive tax planning.

3.67 The ANAO considers that the specialist work of the taskforce has focussed on part of the HWI taxpayer population in accordance with sound risk management principles. The ANAO considers that the degree of on-going risk in this part of the taxpayer population warrants continuing attention, and maintenance of specialist resources to manage that risk as part of an effective tax system.

³³ See paragraph 2.79.

Recommendation No.3

3.68 The ANAO recommends that, subject to appropriate risk assessment, the ATO consider retention of the capability for dealing with the complexity of tax matters characteristic of high wealth individuals and their associated entities.

ATO Response:

3.69 The ATO agrees with the recommendation.

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

Canberra ACT
13 June 2000

P. J. Barrett
Auditor-General

Index

A

advisers 19, 40, 43, 44
Aggressive Tax Planning Steering Committee 46
Annual Report 21, 32, 54, 56, 59
assessment 11-13, 17, 22, 24, 25, 28-31, 33-41, 43, 47, 49, 52, 53, 62
Australian Securities and Investments Commission (ASIC) 30

B

Business Taxation 12, 58

C

Code of Settlement Practice 11, 40, 41
Commissioner of Taxation 9, 18, 25, 32, 35, 47, 54, 56, 59
compliance 9-12, 17-22, 24, 25, 28-31, 34-37, 41-44, 47, 50, 52, 59-61
costs 11, 36, 37, 69
improvement 12, 50
management 11, 12, 24, 25, 29, 31, 34, 37, 43, 60
program 9, 18
risk 9, 18, 31, 34, 35
Compliance Management Strategy 11, 29
Compliance Model 44, 60
Corporate Governance 11, 24, 25, 27-29, 31, 33, 35, 37, 39, 41-43, 45
Corporate Plan 27

D

debt 18, 33, 54
Department of Finance and Administration (DOFA) 51, 53, 55

E

evaluation 10, 11, 22-25, 42-45, 54, 61
Expanded Returns 26, 31, 34-38, 43, 44
expectation statement 27, 28

F

film investment 40, 54

H

Health of the System Assessment (HOTSA) 17, 22
High Wealth Individual (HWI) 9-13, 17-23, 25-42, 44-61
companies 50, 51
entities 50
group 18, 30, 32, 34-36, 38, 42, 49, 55, 58, 59
list 26, 31, 33
Steering Committee 26, 28
taskforce 9, 10, 12, 13, 17, 21-23, 25, 31, 46-50, 52, 55, 56, 59, 60

I

Income Tax Assessment Act 1936 37
Internal Assurance Branch 55

L

Large Business and International (LB&I) business line 25-28, 30, 38-40, 46, 61
legislation 12, 50, 54, 57, 58
legislative 10-12, 19, 20, 34, 47, 54, 56-60
litigation 19, 29, 40-42, 53
losses 18, 20, 32, 48, 53-57

M

Memorandum of Understanding (MoU) 55

N

net wealth 9, 17, 18, 29-31, 33

P

payment arrangement 12, 52, 53

performance indicators 27-29

policy development 65

prosecution 19, 29, 37

R

Ralph Committee 58

Research 18, 25, 26, 29, 30, 36, 54, 56

Research and Development (R&D) 18, 54, 57

Revenue Analysis Branch (RAB) 10, 13, 19, 21, 38, 47, 50, 51, 56, 60

revenue 9-13, 18-22, 26-28, 30, 32, 34, 38, 39, 41, 47-61

at risk 11, 19, 20, 34

targets 10, 12, 48, 53

risk 9-13, 18-20, 22, 25, 28-39, 42, 44, 49, 57, 58, 60-62

analysis 25, 61

assessment 11, 13, 22, 25, 28-31, 33-39, 62

management 10, 12, 13, 22, 29, 44, 60, 61

profiling 61

rulings 19, 28

S

Senate Economics References

Committee 10, 21, 22, 23, 38, 40, 44, 48, 59, 60

Settlement 11, 22, 40, 41, 52

Small Business (SB) 22, 40, 45, 65

T

Tax Counsel Network (TCN) 39, 41

Tax File Number (TFN) 50

Tax Reform Taskforce 58

tax 9-13, 17-20, 22, 23, 25, 28-62

in dispute 10, 11, 23, 40

minimisation 10, 13, 33, 47, 54, 56, 57, 58, 60

planning 9, 11, 12, 18-20, 28-37, 39, 41, 45, 46, 56-8, 61

Taxpayer's Charter 28

Treasurer 20, 26, 28, 54, 58

Treasury 10, 12, 19, 20, 47, 50, 57, 58

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