

Tax and Citizenship

Presentation by Michael D'Ascenzo, Harvard Kennedy School and Irish Tax Institute - Global Tax Policy Conference, Dublin, October 2013.

Introduction

Last year at the opening of the Australian Taxation Office's (ATO) new Melbourne building, a young student, 10-year-old Josh Robb said:

"Did you know that over a hundred years, some of the things tax has paid for are schools, hospitals, roads, the army, looking after the environment, and supporting people in the country that need our help. That's why the Tax Office is important. You collect money for all those things and that's what makes Australia a safe place to live."¹

As Josh points out, a tax system that resources services and infrastructure for the development of social and economic institutions serves the community and helps to build the nation. To quote from one of Australia's taxation forefathers, former Federal Tax Commissioner Robert Ewing – *"A community which taxes itself properly in order to meet its engagements always has a good reputation."*² Furthermore it could be said that a nation's outlook and wellbeing are to a large extent contingent on that nation having an effective and efficient system for raising revenue.

The three key theses of this paper are:

1. If people have a view of taxation that extends beyond numbers to the broader civil, social and economic benefits that they expect for themselves and for new generations, they will be more likely to shoulder a shared responsibility for the care and ownership of their nation's tax system;
2. If you want the community to feel a stronger sense of ownership of their tax system, then the community needs to be involved as much as possible in its design and operation; and

¹At the age of 6 Josh was diagnosed with a relatively rare case of idiosyncratic organ failure. I am often asked who I admire. It is people such as Josh who tackle adversity every day with courage and good cheer.

² R. Ewing: '*Taxes and their incidence*', Melbourne University Commerce Society, 1926, p. 12.

3. The vision and values of the tax authority are critical in building staff engagement and community trust and confidence.

Tax and Citizenship

Tax is not just numbers and obligations; it has qualitative and social dimensions that have a significant impact on the numbers involved. Tax is part of the social contract by which citizens collectively agree to contribute to a civilised society.

The key realisation is that it is the community's tax system after all. Tax is a national framework in which all citizens have an important stake. The community sets the shape and incidence of tax through its elected representatives. Under the construct of most democracies willing compliance with tax obligations becomes a civic as well as a legal responsibility.³

Tax Policy

The role of tax authorities in the tax policy function varies, but in all countries it is the government that has control, and in many countries the government's principal adviser on taxation is not the revenue authority.

Whatever the policy frameworks are in a particular jurisdiction, a policy initiative is more likely to achieve the best possible outcome when the question of how the policy is to be implemented has been an integral part of policy design.⁴

At a policy level successive Australian governments have endorsed principles of consultation in legislative design.

The design of policy can also be refined through 'road testing'.⁵

³ See Viscount Simon's observation that there is no reason why tax avoidance efforts "should be regarded as a commendable exercise of ingenuity or a discharge of the duties of good citizenship." (*Latilla v Inland Revenue Commissioner*: [1943], A11 ER 265 at 266). On the other hand, contrast the view of Lord Tomlin in *Inland Revenue Commissioner v Duke of Westminster*: [1936] AC1.

⁴ Joint Australian National Audit Office and Department of the Prime Minister and Cabinet, '*Better Practice Guide for the Implementation of Programme and Policy Initiatives*', (2006), p.5.

In my opinion, a collaborative tripartite approach to the design of the tax law is useful in improving clarity and administrability⁶, as well as minimising compliance costs.⁷ This would include the Treasury and other government agencies as well as the tax profession, industry and business representatives, and taxpayers.⁸ A collaborative tripartite approach is helpful, in my view, to progress Robert Ewing's ideal of "*taxing properly*".

Public and Tax Administration

A simple encapsulation of public administration describes it as the management and implementation of policies which allow government to function; it is the "*translation of politics into the reality that citizens see every day.*"⁹

It is acknowledged that the national context is important in the style of public administration that occurs in a particular jurisdiction and that jurisdictional differences in administration are to be expected. For example, national administrators face a varied environment within which to administer public systems. Jurisdictions differ in respect of their policy, legislative regimes and the integrity of their institutions, as well as in their cultural norms. Naturally these differences shape administrative responses, and these administrative responses in turn influence the cultural norms of their community.

Nevertheless, in my opinion there are universal themes that underpin a modern tax administration, at least in the context of a democratic environment.

⁵ Board of Taxation, '*Improving Australia: Tax Consultation System*', (2007) at para 3.23-3.24: <http://www.taxboard.gov.au>.

⁶ Joint Committee of Public Accounts, '*Report 326: An Assessment of Tax*', 1993 at p.79: "*A good law can be measured in part by its capacity to be administered.*"

⁷ D'Ascenzo M., '*Taxation Law Design*', *Journal of Australian Taxation* (2002), Vol. 5. Issue 1, Monash University.

⁸ Neil Gregory and Susan Symons, '*Paying Taxes 2011 - The Global Picture*', World Bank, International Finance Corporation and PWC, 2011, p.1.

⁹ Donald Kettl and James Fessler, 2009, '*The Politics of the Administrative Process*', Washington D.C.: CQ Press.

At a simplistic level, tax authorities collect the revenue. However, it is not just collecting tax that is important; it is also how taxes are collected that has a bearing on the nature of the society in question.

The OECD has an insightful observation about revenue:

*“The way in which revenues are collected and spent defines the symbiotic relationship between the state and its citizens, strengthening the former and making it more accountable to the latter.”*¹⁰

Traditionally, in some countries taxes have been collected under a command-and-control model in which any infringement is dealt with harshly or even arbitrarily or capriciously.¹¹ This is even more troubling where the integrity of the administration and other institutions is open to question, or where it operates in a society that does not consistently uphold the rule of law.

Fortunately, taxes in Australia are legislated by Parliament as the representative of the community. The power to tax resides with the Parliament and, as an independent agency of government, the ATO is charged with responsibly administering the legislative intention of Parliament. Australia has enjoyed a tax administration of high integrity¹², and one that has been modern, progressive, and recognised globally as first class.

The pivotal principle that underpins a modern tax authority such as the ATO is the realisation that tax administration, and public administration more broadly, are about serving the community and operating under the ethos of working with the community.¹³

¹⁰ Co-chairs' Statement. *'OECD Joint Meeting of the Committee on Fiscal Affairs and the Development Assistance Committee'*, 27 January 2010.

¹¹ James Coffield, *'A Popular History of Taxation'*, 1970.

¹² *ATO Integrity Framework* (Nat 13036-01.2006, <http://www.ato.gov.au/content/20886.htm>).

¹³ The Indigenous name of the ATO's new Adelaide office, *'Nakurrinthe'*, has a wonderful meaning in the Kurna language. It means *'to see, to know, and to understand each other'*. This name encapsulates an ambition of working together with the community.

Notwithstanding different jurisdictional contexts, all tax authorities should be characterised by a concern for serving the public and for protecting honest taxpayers. These are qualities we can easily take for granted.

Shaping Society

From global poverty to economic development to ageing populations, nations and their governments are acutely conscious of the role of revenue and retirement savings systems in alleviating wicked problems and driving positive change. There is also greater collective focus by revenue authorities worldwide on positively influencing their citizens.

Procedural fairness, courtesy and integrity are crucial aspects of a world class tax administration. This is important because the success of any tax system is highly dependent on people's propensity to voluntarily comply with their tax obligations.

Factors that shape community attitudes and behaviour include:

- the community's belief that the Tax Authority is fair, certain and legitimate,
- perceptions of fairness including:
 - the assistance people receive in relation to their responsibilities under the tax system, and
 - the ease with which people can deal with the Tax Authority,
- issues of respect and natural justice,
- the integrity of the tax authority (and of the government it serves), and
- the perceived effectiveness of deterrence strategies.

The recurring themes of:

- excellent service to taxpayers,
- efficient and effective management of risks to the tax system,
- making it easier for people to comply, and
- building community confidence in the quality and integrity of tax administration,

are goals for any modern and effective tax authority.

In order to shape community attitudes tax authorities need to create trust. And to create trust, they must be open, accountable and of the highest integrity.

Building a Service Culture in a Tax Authority – the ATO story

Over the last two decades in particular, the ATO has adapted to meet the needs of a dynamic and changing environment.¹⁴ Reflecting changes in broader society and the evolution of the ATO's understanding of public administration, what was an organisation heavily dependent on manual processes became high-speed, well qualified, technologically up-to-date, and externally focused and oriented to a modern community.

In 2010 the ATO celebrated its centenary. Stated on its centenary banner, highlighted in its centenary stamp, engraved on its commemorative coin, and inscribed in its history and in its purpose, was the slogan, '*Working for all Australians*'.¹⁵

The journey to reach this point was in the main a cultural one driven by an alignment of the ATO's people with the organisation's vision and values.

Vision and Values

The ATO's vision links willing engagement in the tax system to good citizenship because tax helps to shape the fabric of Australia's society.¹⁶ The ATO's direction and actions to date have been aligned to its vision and values.

The ATO vision as stated in its *2010 Strategic Statement* is: "*Australians value their tax and superannuation systems as community assets, where willing participation is recognised as good citizenship.*"

This vision is underpinned by high level strategies that can be grouped within the following five themes:

¹⁴ Leigh Edmonds, '*Working for all Australians 1910 – 2010; A Brief History of the Australian Taxation Office*', ATO, 2010.

¹⁵ See generally, Commissioner of Taxation, Annual Report, 2009-10.

¹⁶ Commissioner of Taxation, '*Making a difference - the intent behind our strategic statement 2010 – 2015*', (which accompany the release of the *ATO's Strategic statement 2010-15*), ATO, 2010:

<http://www.ato.gov.au/corporate/content.aspx?doc=/content/00245012.htm>.

1. Engage (right from the start, as the ATO has tried to do with new businesses, young Australians and non-English speaking communities)¹⁷,
2. Support (through guidance and assistance, and by making it easier of taxpayers to comply),
3. Protect (by seeking to promote a level playing field, using data matching, analytics, preventative strategies and differentiation),
4. Enhance (through a transformational change program, continuous improvement, user based design, analytics and innovation), and to
5. Champion (with a view to making the tax system simpler, and of making Australia more efficient, especially through the promotion of a more digital Australia)¹⁸.

As I have stressed before, in order to be successful, a tax administration needs to build trust and community confidence. It is difficult to do so unless the administration is fair and professional and is perceived by the community as living these values. This is where the ATO's corporate values were at the heart of putting the taxpayer at the centre of its administration.

Since 2006, the ATO's corporate values have been:

- Being fair and professional,
- Being open and accountable,
- Applying the rule of the law,

¹⁷ Last year the ATO released a new online educational resource, called *Tax, Super & You*. It we designed to help young people learn about the roles tax and superannuation play in supporting the kind of society and way of life we enjoy in Australia.

The ATO has also worked closely with communities from a non-English speaking background and relevant agencies to build strong relationships and to pioneer approaches that nurture good citizenship. For example, the ATO developed a national in-language media and community outreach program; a range of tax products such as the *Tax in Australia* DVD, produced in 16 languages, and the *Your Business and Tax* DVD in 11 languages; as well as contributing to the *Beginning Life in Australia* and the *Citizen Resource Book* published by the Department of Immigration & Citizenship.

In its *Report 426 (2012)*, the Joint Committee of Public Accounts and Audit concluded that the ATO's 'no strings attached' business advisory services were commendable and encouraged wide business sector participation.

¹⁸ For example the ATO championed Standard Business Reporting and the use of XBRL because SBR has the potential to substantially reduce business reporting costs.

- Supporting people who want to do the right thing and being fair but firm with those who don't,
- Being consultative, collaborative and willing to co-design (the 3 C's) – the ATO took the view that a critical element of best practice public administration is to genuinely include the community in the design and operation of administrative systems. In this way the citizen is put at the heart of tax administration, and
- Being responsive to challenges and opportunities.

These values are not the usual gathering of emotive words but rather they have specific application in the context of tax administration.

The ongoing responsibility of building trust and community confidence is promoted where the tax authority is fair and professional in the way it operates. This value encompasses attributes such as respect, courtesy, procedural fairness, and high levels of probity and integrity.

Openness and accountability also nurture trust and community confidence. For example, the ATO was the first, and is still one of only a few tax administrations which make public their assessment of tax risks and areas of focus as part of their annual compliance program. Each year the ATO has published its *Compliance Program*, highlighting the issues that are attracting the ATO's attention, what its risk management approaches are, how it will monitor and treat them, and the consequences of non-compliance.¹⁹

The increasingly collaborative development of its *Compliance Program* with the tax profession, and the annual publication of the Program also provide examples of preventative strategies. The ATO has also developed sophisticated compliance strategies that give flesh to the principle of being fair but firm with those that do not comply with their tax obligations. For example, the ATO's risk management approach uses data matching and analytics to actively manage material risks and issues that may compromise community

¹⁹ See for example, 'ATO Compliance Program 2012-13': <http://www.ato.gov.au/corporate/content.aspx?doc=/content/00326650.htm>.

confidence in the fair and effective administration of Australia's tax and superannuation systems.

A key role of tax authorities is to manage information in a way that allows differentiated approaches both in providing assistance to people (helping them over the line so to speak, and masking complexity to make it as easy as possible for them to comply), and in protecting people from those that default on their legal and civic duties. Ideally this protection is achieved mainly through deterrence and preventative strategies.

In terms of transparency the ATO also made public the results of its many surveys (warts and all).²⁰

The ATO also articulated the conduct it expect of itself, and what taxpayers can expect of it through its *Taxpayers' Charter*²¹, its Service standards, and publications such as the *Large Businesses Tax Compliance* and *Wealthy and Wise* booklets.²²

The essence of a corporate value such as the rule of the law is to distinguish the ATO from administrations that do not necessarily follow their legislative base. The distinction is between potentially arbitrary and capacious decision making reliant on administrative fiat, and an approach that respects rights and responsibilities, supported by judicial authority. What Australia offers is a level of certainty that does not exist everywhere in the world.

As explained, the rule of law value is about providing taxpayers and their advisers with assurance and certainty in the ATO's actions, in contradiction to an arbitrary and potentially capricious or corrupt response. The legal rules under which the ATO operates, and its adherence to them, protect taxpayer rights and give legitimacy to the ATO's administration.

²⁰ As an aside, the ATO's communication's team had been reticent to make public the ATO's survey results on the basis that the media would focus only on the negatives and not on the positives. While this proved to be true, media report improved over time with growing external recognition of the ATO's commitment to transparency. It also demonstrated to ATO staff that the commitment to the values was not just skin deep.

²¹ 'Overview of the Taxpayers' Charter', ATO: <http://www.ato.gov.au/content/25824.htm>.

²² See ATO website, www.ato.gov.au, for these and other ATO publications

In closing the loop on this virtuous circle, working with the community through the 3 C's has the potential to reduce compliance costs for taxpayers. Moreover, the active engagement of the community in the administration of their tax and superannuation systems helps to make progress on the vision that underpins the ATO's strategic statement – where the tax and superannuation systems are seen as community assets and proper participation in them is a hallmark of good citizenship.

The commitment to 'live the values' needs to run deep in the veins of the tax authority if the organisation is to be a values based organisation and successful in cultural change. In particular, the vision and values of the organisation need to resonate so strongly with staff that they have a substantial impact on staff commitment and engagement. This is because the work of tax authorities is not for everyone – it's not for the soft hearted because of the need for fair and consistent application of the law, and it's not for the heartless because there is often scope to help people over the line. It is work that requires fairness and professionalism, vigilance and foresight, and the empathy drawn from a willingness to walk in the shoes of others. Indeed if a tax authority is to promote trust and community confidence, it needs to have a heart.²³

The proof is in the pudding

The ATO has conducted staff engagement surveys which highlighted very high alignment of staff engagement with the ATO's vision and values.²⁴ The last survey, undertaken in 2012, followed an Agency Agreement which had not been supported by a major union. The survey still showed high levels of commitment to the vision and values of the organisation.

In terms of enhancement, the ATO's Change Program represented a top down transformational reform of the organisation's systems and processes.²⁵ The ATO also encouraged bottom up innovation.

²³ Commissioner of Taxation, Annual Report, 2011-12 at p. 7.

²⁴ Commissioner of Taxation, Annual Report, 2011-12 at p. 130.

²⁵ Commissioner of Taxation, Annual Report, 2011-12 at p. 127.

Bottom up innovation starts from having an engaged and committed workforce that cares about the important work it does. In its essence, it is about empowering people to ask the questions: *What are we seeking to achieve?; Why are we doing this?; and Can we do it better?*

A corporate innovation framework was developed by the ATO to help harness the ideas and contributions of staff. This ensured that specific innovations were adopted in the short term, and that innovation and continuous improvement could become an ongoing and self-regenerating feature of the way the organisation worked - part of its 'business as usual'; part of its DNA.

In addition, through the use of many consultative forums, the ATO was able to engage and involve taxpayers and their representatives in the care and management of the community's tax and superannuation systems. Through these forums and other processes the ATO showed its commitment to consultation, collaboration and co-design.

A Commitment to Service

While the ATO's technology and methodologies have changed, its ethos of strong community service has been present from the earliest days. Commissioner Ewing told his staff in 1920 that their "*principal rule*" was "*to assist taxpayers in every way possible so that they shall pay the exact amount of tax required by the law, no more, no less.*"²⁶

I think the secret behind the ATO's success over its hundred years has been its readiness to do this, to embrace change, to look forward, to refresh its infrastructure, culture and skills, and to manage risk with care and courage.

²⁶ Commissioner Ewing's '*Memorandum to Staff*', 26 June 1920, file J97/99, CRS A7073, 1920.

Beyond maintaining the integrity of the tax system²⁷, there is a growing community expectation of excellent service. Today the gold standard for a modern tax administration is one which is increasingly service-oriented, and citizen-centric.

People now demand products and services that suited them, and expect the tax authority to make the tax system easier for them. While the tax authority has a role in influencing law design, within the current legislative framework the goal is to 'mask the complexity' of the tax system for taxpayers, and to try to make their dealings with it as easy and straightforward as possible. For example the ATO has for a while now used prior return and third party data to assist taxpayers by pre-filling tax returns. More recently it has been using this data through the power of analytics to improve its ability to differentiate its response based on the characteristics of the taxpayer. In private sector terms it's about knowing the customer. In this way the ATO can better personalise its support (and compliance) strategies, and tailor its approach according to the particular characteristics of the taxpayer or taxpayer group.

A new twist in modern tax administration is the application of user-based design to make it easier for people to fulfil their tax responsibilities.²⁸ For some time the ATO has been working with the community in designing products and processes to ensure they are user friendly. There is more scope to do so, and also to optimise the input of the 'voice of administration' in the development of tax law design.

The fundamental principles underlying the user-based methodology are:

1. To place the user at the centre of the design process.
2. To ensure all involved in designing and implementing a change share an understanding of the real intent of the change.

²⁷ The ATO uses analytics to predict and analyse areas of risk and emerging patterns in behaviour, allowing the organisation to better allocate scarce resources.

²⁸ More broadly, from the perspective of an individual citizen needing to interact with 'government' in some way, the boundaries between the various agencies and departments are often irrelevant to the problem they may be grappling with. A challenge for the public sector as a whole in the coming years will be to 'join up' its services for people. A user centred design approach will be crucial to successfully meeting this challenge.

3. To design the whole change 'end-to-end' before detailed design of individual components and products.

These principles inform the ATO's mantra of the 3 C's. For tax authorities co-design involves sharing responsibility with the community, and making government policies work seamlessly for most effect and for the lowest possible compliance costs. The positive emotional response that great design can elicit from people in the world of a tax authority may be something like a sense of confidence, security, ownership, and trust.

Improving taxpayer experience (and minimising their costs) has been a prominent ATO strategy for some time. The ATO was the first Commonwealth agency to develop a service charter - the *Taxpayers' Charter*. The *Taxpayers' Charter* continues to guide the ATO's interactions with the community and to affirm the rights and expectations of taxpayers.²⁹ The values it embodies are enduring, and have so far stood the test of time.

Living the Values

A few years ago an OECD benchmarking study found that the ATO devoted proportionately more resources to help and support activities than the other revenue administrations in the survey. The consultants suggested that the ATO could find savings by scaling down activities such as its Small Business Assistance Program and the level of support the ATO provided to tax practitioners. The ATO did not agree, because these strategies were consistent and integrated with its vision and values.

During a natural disaster, such as flood, cyclone or bushfire, the ATO's message in recent years has been that tax matters should be set aside while people are dealing with trauma and the basics of survival, and that the ATO will be there to help when people are ready to return to their everyday functions of normal life.³⁰ This too is about ATO staff putting themselves in the shoes of others.

An even more definitive example of the ATO's values in action occurred during the global financial crisis. A very tangible way in which the ATO helped viable businesses in short term financial difficulties was the provision of flexible payment arrangements (some on interest free terms) aligned with the business' cash flow. Cash flow relief was also provided to

²⁹ Commissioner of Taxation, Annual Report, 2007-8, p.2.

³⁰ Commissioner of Taxation, Annual Report, 2008-9, p.1-3.

businesses through deferrals of the due date for payment of activity statements. This empathetic approach was testament to the corporate value of helping honest taxpayers over the line. One commentator articulated the worth of these strategies as follows: *“Without the far sighted proactive work the ATO undertook there would have been carnage in the small and medium enterprise sector. The ATO stepped up to the plate and delivered in a way we in the sector never imagined they would. They were helping businesses up and down the scale. To me it went business handouts and extra deductions for expenses – it was real help and it continues today.”*³¹

Dealing with business – large, small and disengaged

Compliance

*“Many countries now emphasise co-operative compliance (e.g. through the use of a compliance model). This can be seen as best practice. Of course, it works better with a system of consultation and responsive regulation. The Australian Tax Office has been a pioneer in this approach, and is frequently viewed as one of the world's leading tax administrations.”*³²

A significant milestone along the compliance improvement journey was the development of the *ATO Compliance Model* which differentiates between the economic, psychological, and social circumstances of taxpayers.³³ This model has been described as responsive regulation.³⁴ Fundamentally, it is about addressing the causes of non-compliance and not just the symptoms.

While the following description under-states both the ATO's emphasis on assistance and guidance and its efforts to make compliance as easy as possible (e.g. *e-tax* and pre-filing), it

³¹ Curt Rendell, cited in Commissioner of Taxation, Annual Report 2009-10, at p.53.

³² John Haseldine, *The Search for Best Practice Tax Administration*, Harbours and Horizons in Tax Administration, 2008.

³³ *ATO Compliance Model*: <http://www.ato.gov.au/content/5704.htm>. The OECD's Compliance Model is based on the ATO's Compliance Model.

³⁴ Valerie Braithwaite, *Responsive Regulation and Taxation*, Law & Policy, Vol. 29, No 1, January 2007.

highlights the importance of having a finely grained understanding of the taxpayer and of the proportionality of the administrative response:

"The responsive regulation approach is based on the proposition that effective enforcement requires a dynamic and gradual application of less to more severe sanctions and regulatory interventions. The Australian approach also advocates a deeper understanding of the motivations, circumstances and characteristics of taxpayers".³⁵

Like any government agency, the ATO's resources to carry out its wide range of responsibilities have always been limited, and so it operates on a risk-management basis. This means it has to make informed choices as to the allocation of scarce resources to best serve the community. This task is about anticipating potential risks (help and assistance activities, information and guidance, and preventative strategies), as well as detecting and dealing with existing risks (again by addressing the causes of the risk and not just the symptoms).

Prevention is better than Cure

Some policy options adopted by Government can assist in locking in high levels of compliance, for example withholding regimes such as 'pay-as-you-go'.

In addition, most tax authorities seek to facilitate a level playing field, but they work in an environment of information asymmetry - it is not immediately obvious who may not have complied or the underlying reasons why they did not. The administrator can, to an extent, control the risk exposure of the broader community by building systems, such as risk engines to detect potential errors, and conducting expensive risk assessments and audits to detect and correct positions which in the view of the administrator do not accord with the law. However these actions are typically after the fact, although they do have a deterrent effect.³⁶

³⁵ Sagit Leviner, 'A New Era of Tax Enforcement: From 'Big Stick' to Responsive Regulation', Michigan Law School, 2006.

³⁶ The power of analytics is fast becoming central to supporting and protecting taxpayers, tailoring service delivery and in the operation of an efficient and effective tax

For some taxpayers information asymmetry is also a significant hindrance to proper compliance with their tax obligations. Hence the need for tax authorities to provide guidance about its interpretation of how the law applies, and about what is required in the exercise of taxpayer rights and legal responsibilities.

For individual taxpayers and for businesses large or small, the ATO has provided them with materials to help them understand their rights and responsibilities. For example the ATO publishes a range of information, advice and guidance and its website, *www.ato.gov.au*, provides substantial guidance to taxpayers and to tax practitioners. The ATO even makes public the legal database which it uses to inform its own decision-making,

There are also features of the Australian landscape, some legislative, some administrative, that are apt to provide high levels of legal or practical certainty to taxpayers and their advisers. These include a binding public ruling system, a binding and renewable private ruling³⁷ system, advance pricing agreements³⁷, annual compliance arrangements, and early engagement opportunities on contentious matters.

With the move to self-assessment in the late 1980's the ATO championed a system of private and public rulings that improved the certainty and fairness of the tax system.³⁸ A private ruling sets out the ATO's opinion about the way a tax law applies, or would apply, to a taxpayer in relation to a specified scheme or circumstance. Two key, and relatively unique, features of Australia's private ruling system are that the rulings are binding on the Commissioner (but not the taxpayer), and the rulings are reviewable by the Administrative Appeals Tribunal or by the courts.

administration. For example, the ATO's refund fraud models identify suspect tax returns for errors or fraudulent activity including identity fraud.

³⁷ See Michelle Markham, *Advance Pricing Agreements: Post, Present and Future*, Walters Kluwer, 2012.

³⁸ Joint Committee of Public Accounts, *Report 326: An Assessment of Tax*, AGPS, Canberra, 1993, at p.70-71.

Public rulings provide the ATO's interpretation of the tax law on issues of wide application. The Public Rulings Sub-Committee of the National Tax Liaison Group helped the ATO determine the topics to be included in the ATO's Public Rulings Program. These public rulings are developed through a rigorous process which involves a Public Rulings Panel which includes independent external tax experts.

More recently, the ATO has been increasing its use of alternative dispute resolution processes to provide a cost effective, informal, consensual and speedier means of resolving disputes and litigation.³⁹

Mutual transparency

Embedded in the ATO's *Strategic Statement 2010-15* was an attempt to shift the ATO's thinking and that of the community. The ATO has over the past decade focused increasingly on early engagement, greater differentiation, and encouraging, supporting and championing mutual transparency through enhancing relationships with taxpayers and their advisers. Adopting this approach the ATO has sought to foster a "no surprises" environment with those taxpayers who saw advantages in reciprocating in a more open and ongoing relationship.

The societal shift that this new thinking could engender would be to a movement from a 'game of hide and seek' to one of mutual transparency in the management of tax risks.

Small Business

The ATO offers practical assistance and support to businesses through its small business assistance program, a range of over 50 online calculators and tools, as well as other materials.⁴⁰ The ATO has also worked closely with industry associations and registered tax practitioners to promote good record keeping practices.

³⁹ Commissioner of Taxation, Annual Report 2011-12, p. 92-97.

⁴⁰ The ATO has guidance materials to help businesses at their start up, when they grow and take on employees, when they face short term difficulties such as illness or injury or are affected by natural disasters, or when they undergo the business equivalent of metamorphosis, such as changing from a sole trader to a partnership or company.

Where businesses are hesitant to contact the ATO directly they have been encouraged to approach their business association or representative body to be the go between in resolving issues or seeking assistance.

The small business sector was appreciative of these efforts:

*"The Australian Taxation Office (ATO) is always looking for new ways to communicate with business people and new processes that can help us comply with a complicated system. The ATO seems to understand that the best way to get the desired result is to assist small business people to comply, not to brow beat them with insulting remarks or assumptions."*⁴¹

In recent years the OECD's Forum on Tax Administration has led advancements in tax administration, particularly in the areas of assisting small business and improving voluntary compliance. The encouragement of good taxpayers' habits by the FTA's *'Right from the Start'* report includes initiatives such the proactive use of pre-lodgment help, relationship management, collaborative design, access to information, and community engagement. These initiatives reflect best practice and provide mutual benefits to the taxpayer and the tax administrator.

The ATO's small business assistance and new to business programs, and the focus the ATO has had with young Australians and migrants reflects a right from the start philosophy.

The Cash Economy

In the small business segment the rogue cog in the wheel is often the cash economy (the shadow economy).

Small business benchmarks are one of the tools the ATO has used to identify businesses potentially engaging in the cash economy. The ATO has developed and published over 100 industry benchmarks which include both performance and input data. The information used

⁴¹ COSBOA Director and CEO of the National Independent Retailers Association, Peter Strong, noted the strength of the ATO approach in the May 2011 issue of *'My Business'*.

to develop the benchmarks is drawn from details provided in the tax returns of businesses across Australia.

Benchmarks are often a range which accommodates a level of variability, and ATO follow-up action targets significant variation from that range. The ATO takes into account the individual circumstances of each business that is reviewed, based upon the records maintained by that business. If a business is materially outside the benchmark, and is subject to review and/or audit, that business is given the opportunity to demonstrate how it recorded total sales and to provide a reasonable basis to support its position.

Importantly, the transparency of the benchmarks have proven to be effective in themselves in lifting levels of voluntary compliance.

Large Business

In 2008 the OECD's Forum on Tax Administration released a report on the role of intermediaries that considered the tripartite relationship between revenue bodies, taxpayers and tax intermediaries.⁴² The major recommendation was for revenue bodies to develop enhanced relationships with large business. The premise was that if revenue bodies demonstrate the attributes of understanding based on commercial awareness; impartiality; proportionality; openness; and have effective risk-management processes in place, this should encourage large corporate taxpayers to engage in a positive relationship with revenue bodies. The expected result is an enhanced relationship based on co-operation and trust, with both parties going beyond their statutory obligations.

Over the last decade, the ATO has sought to implement the spirit behind this philosophy through three key strategies:

1. Tax and the Boardroom
2. The Risk Differentiation Framework, and
3. Annual Compliance Arrangements.

⁴² OECD FTA, (2008), *'Study into the role of tax intermediaries'*, OECD Publishing.

Tax and the Boardroom

The ATO promoted as best practice the inclusion of material tax risk within the risk management and governance frameworks of large companies.⁴³

The OECD's *'Guidelines for multinational enterprises'* endorsed such an approach. These guidelines provide voluntary principles and standards for responsible business conduct consistent with applicable laws and include a *Tax Charter* that contains the following: *"It is important that enterprises contribute to the public finances of host countries by making timely payment of their tax liabilities. In particular, enterprises should comply with both the letter and spirit of the tax laws and regulations of the countries in which they operate. Complying with the spirit of the law means discerning and following the intention of the legislature. It does not require an enterprise to make payment in excess of the amount legally required pursuant to such an interpretation. Tax compliance includes such measures as providing to the relevant authorities timely information that is relevant or required by law for purposes of the correct determination of taxes to be assessed in connection with their operations and conforming transfer pricing practices to the arm's length principle.*

Enterprises should treat tax governance and tax compliance as important elements of their oversight and broader risk management systems. In particular, corporate boards should adopt tax risk management strategies to ensure that the financial, regulatory and reputational risks associated with taxation are fully identified and evaluated.

Enterprises' commitments to co-operation, transparency and tax compliance should be reflected in risk management systems, structures and policies. In the case of enterprises having a corporate legal form, corporate boards are in a position to oversee tax risk in a number of ways. For example, corporate boards should proactively develop appropriate tax policy principles, as well as establish internal tax control systems so that the actions of management are consistent with the views of the board with regard to tax risk. The board

⁴³ See *'Tax Risk Management'*, 2007, Lexis Nexis/Butterworths; and Ernst and Young, *'Tax risk: External change, Internal Challenge-the Australian perspective: Global Tax Risk Survey 2006-2007'*, March 2007.

should be informed about all potentially material tax risks and responsibility should be assigned for performing internal tax control functions and reporting to the board. A comprehensive risk management strategy that includes tax will allow the enterprise to not only act as a good corporate citizen but also to effectively manage tax risk, which can serve to avoid major financial, regulatory and reputation risk for an enterprise.”⁴⁴

Risk Differentiation Framework

As between taxpayers in the large market sector, the ATO’s Risk Differentiation Framework (RDF) allows the ATO to make more informed choices about the attention to be given to particular taxpayers. The RDF takes into account the likelihood that a taxpayer will adopt a particular approach to compliance and also the impact or consequence of any potential non-compliance. Last year the ATO informed large businesses in a single letter about its view of their relative risk of non-compliance for income tax, goods and services tax and excise. The Commissioner personally wrote to the top 100 companies explaining the ATO’s thinking; outlining any concerns; and providing a degree of practical certainty regarding the likelihood of contact from the ATO.

Boards and CEOs of many of the largest corporate groups are showing substantial interest in these letters, and in this way the ATO is ensuring that material tax risks are being brought within a company’s governance frameworks. The sharing of the ATO’s view of the tax risk with businesses is a significant move towards a more cooperative, real time, risk management approach, and has been called a ‘game-changer’.

Annual Compliance Arrangements

For large business, the ATO offers Annual Compliance Arrangements (ACAs) which set a mutual tone from the top based on transparency and real time mitigation of tax risks. ACAs involve a sharing of views by the tax authority and by the taxpayer as to the company group’s potential tax risks. ACAs are capable of providing the taxpayer with a degree of

⁴⁴ OECD (2011), ‘*OECD Guidelines for Multinational Enterprises*’, OECD Publishing: <http://dx.doi.org/10.1787/9789264115415-en>.

practical certainty in real time. They offer a "no surprises" approach which benefits both the business and the ATO, and reduces the likelihood of having to work through traditional compliance approaches such as risk reviews and audits. ACAs also link in well with the concept of including tax risks within the risk management frameworks of large businesses.

The RDF and ACA's now provide a new and exciting paradigm in the way large companies can manage their tax risks – changing cultures both within and outside the tax administration.

Tax Advisers – there to help or to hinder?

The ATO places significant reliance on the integrity and professionalism of intermediaries in the tax system.⁴⁵

In Australia intermediaries such as registered tax agents have a symbiotic relationship with the tax administration. These intermediaries provide a key leverage point to influence taxpayer behaviour and to facilitate streamlined and increasing online dealings with the ATO.⁴⁶

At the strategic level, it is important that tax agents are capable of carrying out this role and that they are well regulated.

A new Tax Agent Services Board commenced on 1 March 2010 to provide a consistent registration and regulatory regime for tax and BAS agents across Australia.⁴⁷ The Board should play an important role in ensuring the integrity and professionalism of the tax industry.⁴⁸

⁴⁵ Commissioner of Taxation, 'Tax Practitioner Action Plan', CPA Sydney Professional Accountant's Group, 2 February 2012: <http://www.ato.gov.au/content/00307038.htm>.

⁴⁶ Another important intermediary are software developers.

⁴⁷ The introduction of safe harbour provisions for taxpayers may be a relationship breakthrough for agents and their clients. These are essentially consumer protection measures for the benefit of taxpayers, but also provide an incentive for taxpayers to use tax agents. Safe harbour means that taxpayers who engage a registered tax or BAS agent are not liable for administrative penalties provided they take reasonable care in providing relevant information to the agent.

⁴⁸ One of the ways the Board will bolster the integrity of the industry is through the establishment of a code of professional conduct which will apply to all registered agents.

The ATO and tax agents have had this symbiotic relationship at least since the unification of the income tax laws in 1942. It is a model that has worked well for Australia, even though there are sometimes criticisms of the heavy dependence of Australian taxpayers on tax agents.

With modern technology there is today less of a need for the ATO to stagger lodgment dates, so the traditional win-win situation of the 1940s has less relevance now. The fact that the ATO has maintained a special lodgment program for tax agents speaks loudly about the ATO's support for tax agents. The ATO has taken the view that tax agents play an important role in helping their clients comply with their tax responsibilities. In addition tax agents, who invariably use the Tax Agent Portal, still oil the mechanisms that make the ATO's administrative processes run smoothly, reducing compliance costs for taxpayers and generally helping to make Australian businesses more accountable and efficient.

Importantly tax agents also help ensure that taxpayers' rights are protected. In doing this they help the ATO live its corporate values and the commitments it makes in the *Taxpayers' Charter*.

Registered tax agents hold positions of trust in the Australian tax system and overall are positive influencers of willing and proper compliance. However a small minority of tax agents are associated with a significant level of non-compliance by clients. For example, out of 26,000 registered tax agents:

- 1,600 tax agents represent half the taxpayers who use agents and have outstanding returns;
- 1,700 tax agents represent 50% of the taxpayers who are significantly outside the small business benchmarks; and

The code is based on commonly accepted values including honesty and integrity, independence, confidentiality and competence.

- 1,600 agents (with more than 100 clients) were identified as having an unusually high level of claims for work related expenses.

The position with law and accounting advisory groups is broadly similar and positive. However, the ATO's on-going reviews of these firms (and financial institutions) have identified a relatively small number of firms and individual advisors that appear to be advocating or supporting highly contentious tax positions.⁴⁹

The higher the ATO views the likelihood of a taxpayer having a contentious arrangement the more likely it is to look at it. The higher the consequences of a contentious arrangement, the greater the intensity when they look. The strategies that flow from this framework range from ongoing but light-touch engagement and relationship management at the more compliant end of the spectrum to intensive and visible deterrence and investigation at the high risk end.

So my overall assessment is that most tax advisers are there to help. More broadly, tax professionals can work in the public interest by giving balanced advice to their clients including advice on the inherent risks; by constructive input on the shape of the tax system; by sharing intelligence with the revenue authority on how the tax system is operating on the ground; and by providing feedback on the quality of tax administration.⁵⁰

Conclusion

So, to reiterate, good tax administration starts from the philosophy that underpins the thinking and actions of the tax authority. Best practice is about the frameworks created to support the tax authority's vision and corporate values and is also dependent on the depth of staff alignment with those values and vision. Lifting the bar on excellence in tax administration is about building trust in the administration of the tax system by being fair and professional; it is about transparency and accountability; it is about consultation,

⁴⁹ Commissioner of Taxation, *'Measure for Measure: The Four Pillars of Compliance'*, 2011, CEDA Trustees Roundtable, Melbourne.

⁵⁰ Commissioner of Taxation, *'Playing it responsibly – The global financial crisis: an ATO perspective'*, 2008, Victorian Tax Bar Association, Melbourne; and *'Cultural Shifts in Thinking? What if?'*, 2006.

collaboration and co-design; it is about integrity; and it is about being empathetic as well as vigilant.

A commitment to working with the community and encouraging good tax behaviour, making tax compliance as low cost and easy as possible for people, 'walking the talk' by helping honest taxpayers over the line and protecting them from those that seek to abuse the system – these are all strategies that will sustain a modern tax administration and tax system for the long term.

I was fortunate to have led a tax administration whose staff were committed and engaged at a practical and emotional level to the vision and values of the organisation. Living the corporate values helped them step into the shoes of others, treating the taxpayer as we would expect to be treated in the circumstances. This is the genesis of a virtuous circle of engagement, innovation and delivery for the nation, for our kids and for their kids.